Calendar No. 1056

98TH CONGRESS *2d Session*	SENATE	REPORT 98-560

THE FINANCIAL SERVICES COMPETITIVE EQUITY ACT

REPORT

OF THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

TO ACCOMPANY

S. 2851

together with

ADDITIONAL VIEWS

JULY 17, 1984.—Ordered to be printed

Filed under authority of the order of the Senate of June 29 (legislative day, June 25), 1984

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Filed under authority of the order of the Senate of June 29 (legislative day, June 25), 1984

Mr. GARN, from the Committee on Banking, Housing, and Urban Affairs, submitted the following

REPORT

together with

ADDITIONAL VIEWS

[To accompany S. 2851]

INTRODUCTION

On June 27, 1984, the Senate Banking Committee marked up and ordered to be reported a bill, the Financial Services Competitive Equity Act, which is designed to clarify and revise the statutory framework under which financial institutions operate and compete. It deals with many diverse issues, including the definition of the term "bank", interstate regional banking agreements, check holding policies of depository institutions, and certain securities powers of depository organizations, yet it is not as comprehensive in the bank powers area as earlier versions of the legislation considered during Committee hearings within the past few years. As such, it represents several years of effort by the Committee to resolve some of the major financial institutions issues. It reflects many compromises made by Committee members and provides a much needed national policy response to questions raised by the rapid changes occurring within our nation's financial system.

The following is a general summary of the bill:

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THE FINANCIAL SERVICES COMPETITIVE EQUITY ACT

TITLE I

1. Definition of "bank"

(a) Federal Deposit Insurance Corporation ("FDIC")-insured bank;

(b) any institution that accepts transactions accounts (for example, checking accounts and NOW accounts) and is engaged in the business of making commercial loans; or

(c) any FDIC-insured, state stock savings bank in existence as of October 15, 1982 which is engaged in the business of making commercial loans and is not a Federal savings bank on the date of enactment.

"Commercial loans" is defined to exclude, among other things, personal loans, loans secured by real estate, the purchase of installment loans (accounts receivable), and investments such as commercial paper, certificates of deposit and similar money market instruments. An institution shall not be deemed to "engage in the business of making commercial loans" if it has no more than 10 percent of its total assets in commercial loans.

(d) Exemptions:

(i) Federal Savings and Loan Insurance Corporation ("FSLIC") insured and Federal Home Loan Bank chartered thrifts;

(ii) trust companies; and

(iii) Edge Act subsidiaries, certain foreign institutions, and similar U.S. domestic facilities engaged in international transactions.

This revision of the definition of a "bank" covers traditional banks as well as institutions offering substantially similar services. Some commercial lending is permitted for non-federally insured state chartered institutions and certain state chartered savings banks coverd by this provision, without bringing such institutions within the scope of this definition.

2. Permitted investments and powers

(a) Securities (directly by a bank holding company or through a separate bank holding company nonbank subsidiary)—

(i) New powers—underwriting and dealing in revenue bonds, commercial paper and mortgage backed securities—as well as existing bank securities powers (including general obligation bond underwriting and certain securities brokerage activities).

(ii) No common name permitted between a bank and its bank holding company securities affiliate.

(b) Other nonbanking permissible activities, under Section 4(c)(8) of the Bank Holding Company Act ("BHC Act")—"closely elated" to banking and, in applying that test, the Federal Reserve is required to "take into account technological or other innovations in the provision of banking or banking-related services".

(c) Leasing authority of national banks—The personal property leasing authority of national banks is made consistent with comparable authority contained in the Garn-St Germain Act applicable to Federal thrift institutions—authorizes personal property leasing with an overall investment limit of 10 percent of a national bank's total assets.

3. Grandfathering of existing limited purpose banks—July 1, 1983

(a) Any company which controlled a nonbank bank before July 1, 1983 is grandfathered, provided it does not commence any additional financial nature activities not engaged in on July 27 1984, and which are not permissible for bank holding companies. This would not limit the nonfinancial activities of a parent company of a nonbank bank.

(b) Any company which acquired a nonbank bank between the July 1, 1983 date and the date of enactment would not be grandfathered and would have to divest the bank or the impermissible activities. A company which acquired or established a nonbank bank on or after July 1, 1983 across state lines which would have been impermissible under the Douglas Amendment had the new "bank" definition been in effect, would have to divest the nonbank bank.

4. Holding company formations and related procedural provisions

Formations of bank or savings and loan holding companies resulting from internal reorganizations would be facilitated through a notice procedure and the application process under section 4(c)(8) of the BHC Act would also be changed to a notice procedure.

5. State actions

(a) Applies the insurance activities limitations of Title VI of the Garn-St Germain Act to a bank subsidiary of bank holding company, and

(b) Prohibits a state bank owned by a bank holding company from engaging in activities outside the bank's home state which are impermissible under section 4(c)(8) of the BHC Act.

6. Thrift institutions

(a) Qualified thrift lender ("QTL") defined

(i) 60% of assets in residential real estate (mortgages, mortgage-backed securities, used in the business), liquidity investment to the extent required by the Federal Home Loan Bank Board under federal liquidity standards, and a limited credit for mortgage banking loan originations (the total credit for liquidity and/or mortgage banking activities would be a maximum of 10 percent of assets).

(ii) any "insured institution" which was a state chartered savings bank prior to October 15, 1982, and which is on the date of enactment of federally chartered savings bank would have 10 years to comply with the above requirement.

(iii) any savings bank which is state chartered, in stock form and FDIC-insured on the date of enactment, and has 10 percent or less of its assets in commercial loans.

(b) Parent of a qualified thrift lender would become a savings and loan holding company upon loss of qualified thrift lender status.

(c) Grandfather date—July 1, 1983, and related provisions, similar to those applicable to banks.

(d) Mutual thrifts would be authorized to form a savings and loan holding company to engage in multiple savings and loan holding company (except insurance agency) activities and bank holding company activities.

(e) Federal savings and loan associations are authorized to offer demand deposits (checking accounts) to all their customers. Presently, they may only offer such accounts to businesses with whom they have a credit relationship. The existing prohibition against the payment of interest on such accounts would be retained.

(f) Members of the Federal Home Loan Bank system would be required to meet the residential real estate test for qualified thrift lenders in order to obtain advances from a Federal Home Loan Bank. The Bank Board would be authorized to waive such requirement in appropriate circumstances.

(g) The capital assistance programs established by the Garn-St Germain Act and implemented by the FDIC and the Bank Board would be extended three years beyond its 1985 expiration date.

(h) Federal associations are authorized to establish or invest in separate subsidiaries of such thrifts solely to issue and service mortgage-backed securities. Other provisions of the Act would authorize Federal thrift organizations to underwrite the deal in mortgage-backed securities through separate holding company subsidiaries.

7. Sections 20 and 32 of the Glass-Steagall Act

The prohibitions against control affiliations and management interlocks between member banks and securities firms are extended to cover nonmember banks and FSLIC-insured thrifts. Such relationships commenced prior to July 1, 1983 would have to be grandfathered and any prohibited relationship would have to be terminated within two years after the date of enactment.

TITLE II—CREDIT UNION AMENDMENTS

Authorizes second mortgage loans beyond 15 years, revises the traditional fidelity bond coverage standard to ensure that it is comparable to other financial institutions, permits a federally-insured credit union to convert to state-insured status by majority vote of a credit union's members (similar to the vote required for a federal to state charter switch), and makes permanent the conservatorship authority of the National Credit Union Administration ("NCUA Board").

TITLE III—BANKERS BANKS

Clarifies that bankers' banks may invest in export trading companies, provide services to bank holding companies, and makes technical changes to the bankers bank statutory provisions.

TITLE IV—INTEREST ON RESERVES

Interest payable on reserves held against the money market deposit account and similar transactions accounts authorized by the DIDC after December 1, 1982.

TITLE V—CONSUMER LEASES AND LEASE-PURCHASE AGREEMENTS

Increased and more effective disclosure and advertising standards applicable to such agreements.

TITLE VI—FAIR DEPOSIT AVAILABILITY (CHECK HOLDING POLICIES)

Establishment of standards covering the check holding policies of depository institutions and directive to the Federal Reserve Board to implement policies designed to accommodate more timely crediting of check items.

TITLE VII—CREDIT DEREGULATION AND AVAILABILITY

Three year preemption (with state override option) of state agricultural and business usury ceilings. A ceiling of 5 percent above the 3 year Treasury securities index is established on all preempted loans.

TITLE VIII—CREDIT CARD FRAUD

Establishment of liability standards and penalties for credit card fraud.

TITLE IX—DEPOSIT BROKERS

No federally-insured institution would be permitted to receive short-term brokered deposits (defined as deposits of less than one year or a longer-term variable rate deposit whose rate is tied to an index of one year or less) in excess of the lesser of 200 percent of its capital or 15 percent of its total deposits nor would any such institution with less than the minimum net worth requirement established by the Federal Home Loan Bank Board, the FDIC or other appropriate bank regulatory agency be permitted to accept any such deposits.

TITLE X—INTERSTATE BANKING

Regional interstate banking agreements are authorized for a five year period, with a Presidential report on the effects of such laws to be submitted within four years. Any merger or acquisition transaction entered into within the five year period would be permanently authorized.

TITLE XI—MISCELLANEOUS

(1) Makes permanent the exemption for advances on open-end credit plans from Truth-in-Lending rescission requirements,

(2) Authorizes NOW accounts for political committees,

(3) Deletes the exemption for attorneys from the provisions of the Fair Debt Collection Practices Act,

(4) Prohibit a company from buying large blocks of its securities from prospective acquirors ("greenmail") and prohibits a company from providing lucrative compensation packages to officers or directors who might be adversely affected by a tender offer ("golden parachutes"). The effective date of these is June 27, 1984.

HISTORY OF THE LEGISLATION

Beginning with the Depository Institutions Deregulation and Monetary Control Act of 1980, more rapid changes have occurred within the financial services industry than occurred in the past two decades. Change begain in the 1970's but it was not until the

1980 Act that Congress mandated the phase-out of deposit interest rate controls (referred to generally as the Federal Reserve's Regulation Q) and authorized NOW accounts nationwide.

The regulatory framework established in the 1930's to compartmentalize financial institutions has come under increased pressure in the past several years as technological advances became widespread, economic uncertainties caused consumers to become more aware of the value of their money and investments, and organizations established innovate products and services outside the traditional regulatory framework to meet consumer financial needs conveniently and efficiently.

In October 1982, the Garn-St Germain Act was enacted, which focused principally on thift problems, but which also affected all participants in the financial system through the establishment of the insured money market deposit account. This Act provided the thrift industry with temporary capital assistance and permanent expanded powers and all but finished the phase-out of deposit rate ceilings—four years before the 1986 date set by Congress in 1980.

The Senate legislation preceding the Garn-St Germain Act, S. 1720, contained provisions authorizing banks to engage in new securities activities. These revenue bond underwriting and mutual bond sponsorship provisions were deleted from the bill marked up and reported out by this Committee, but not before there were extensive hearings on this subject. Moreover, the Treasury Department developed a legislative proposal in early 1982, S. 2490, which authorized banking organizations to engage in additional securities activities but only through a separate subsidiary of a bank holding company. In addition to the general Committee hearings on S. 1720, four days of hearings were held in the Committee's Securities Subcommittee in February of 1982 on the specific issues raised by the securities provisions of S. 1720 and S. 2490.

As traditional depository organizations were limited by deposit rate ceilings, other nonbanking companies began to increase their presence and activity level in retail depository services. Beginning with the acquisition in 1980 of a limited purpose consumer bank or "nonbank bank" by Gulf and Western Corporation, dozens of other companies have acquired such nonbank institutions. Such institutions obtain a bank charter and federal deposit insurance, but avoid subjecting the parent company to the requirements and limitations of the BHC Act. The term "bank" is defined in the BHC as an institution which accepts demand deposits (checking accounts) and is engaged in the business of making commercial loans. The great majority of companies desirous of owning a bank but wishing to avoid the compliance with the BHC Act have terminated commercial lending activities.

With the proliferation of nonbank banks, some of the federal regulators expressed concern that the financial system would continue to evolve through the development of "loopholes", marked by the growing strength of new national competitors against depository organizations which have continued to be constrained by product and geographical restrictions, as well as regulatory limitations unless Congress dealt with the "bank" definition issue.

With the 98th Congress, continued attention was paid to the changes occurring within the financial system. Several days of

oversight hearings were held by the Committee in the spring of 1983. The Comptroller of the Currency, facing new applications for "nonbank banks", issued a regulatory moratorium against approvals for any such new applications. He did this in order to provide Congress with time in which it could decide what the national policy should be in this area. This moratorium ended this past March and was subsequently renewed through the end of this year.

The concern about nonbank banks in the spring of 1983 led to the filing of bills designed to redefine "banks" and impose statutory moratoriums against the establishment of nonbank banks. The Federal Reserve proposed a moratorium, S. 1532, and the FDIC proposed (contingent upon Congress' inability to deal with broader issues) a permanent redefinition of "bank" and other restrictions to limit the mixture of bank and nonbank operations and services.

In July 1983, Senators Garn and Proxmire introduced, at the request of the Administration, a bill (S. 1609) to authorize new securities, real estate, insurance, and financial activities for bank holding companies, to redefine the word "bank", to streamline bank holding company formation procedures, and to provide for functional regulation of holding company activities. Committee hearings were held on S. 1609 and the moratorium bills in July and September 1983.

In November 1983, Senator Heinz introduced S. 2071, a bill to redefine the term "bank" in order to close the so-called non-bank bank "loophole", and Senator Heinz and Dodd introduced S. 2072, a bill to limit states' authority to expand the powers of bank and other subsidiaries of bank holding companies.

After considering the comments of those participating in the hearings, Senators Garn and Proxmire each introduced legislation to increase bank holding company powers and close the "nonbank bank" option. Senator Garn's bill, S. 2181, covers many additional issues, including credit card fraud, check holding policies, interstate regional banking agreements, and usury preemption, in addition to those dealt with in S. 1609. S. 2181 includes seven other bills which were introduced separately during 1983. These bills and their sponsors-are:

S. 1750: Senators Heinz, Garn, Tower, and Mattingly. Payment of interest on reserves maintained on interest bearing transaction accounts and money market deposit accounts.

S. 1152: Senator Hawkins. Consumer leasing disclosure simplification.

S. 573: Senators Dodd, Proxmire, D'Amato, and Cranston. Requiring banks to disclose more information to their customers about check holding policies.

S. 730: Senator Garn, Proxmire, and Lugar. Preemption of states' business, agricultural, and consumer loan rate ceilings.

S. 1875: Senators Garn and Proxmire, by request of DIDC. Authorize interest on checking accounts.

S. 1002: Senator Tsongas. New England interstate banking experiment, expanded to include other regional arrangements. (Subsequent to the introduction of S. 2181, Senator Mattingly introduced a regional interstate banking bill, S. 2113, and Senator D'Amato introduced a bill, S. 2107, to phase out all existing restrictions against interstate banking operations.)

S. 1555: Senators Hawkins, D'Amato, Dodd, and Garn. Restricts the use by creditors and businesses of credit card owner identification information to prevent credit card fraud.

Senator Proxmire's bill, S. 2134, contains comparable provisions to much of what is in S. 1609 and S. 2181, such as new securities powers for bank holding companies, streamlined holding company application procedures, and the separate subsidiary approach for new holding company activities adopted in S. 1609 and S. 2181.

The bill used as the basis of the Committee's mark-up was a revised version of S. 2181. It contained all of the titles from S. 2181 except for the one authorizing interest to be paid on checking account balances. Also not included in the bill were the provisions authorizing bank holding companies to engage in real estate and insurance activities.

On June 27, 1984, the Committee marked-up and ordered to be reported, without any dissenting vote, S. 2851, the Financial Services Competitive Equity Act. The principal changes made during the mark-up were to expand the grandfather exemption for companies owning nonbank banks and for banks subjected to the Glass-Steagall Act limitations, apply the insurance activities restrictions to Title VI of the Garn-St Germain Act to bank subsidiaries of bank holding companies, establish an interest rate cap on business and agricultural loans covered by the usury preemption provisions, and establish prohibitions against a company buying blocks of securities from prospective acquirors to avoid a takeover ("greenmail") and providing lucrative compensation arrangements for officers and directors in the face of an impending takeover ("golden parachute").

In summary, the issues in the bill as reported are not new and have been the subject of 26 days of hearings over the last 15 months. The Committee also held hearings on the Treasury proposal and on the various nonbank moratorium bills, as well as oversight hearings. In connection with S. 2181, the Committee heard testimony from 72 witnesses, who were representative of many groups interested in changes in the banking industry. Not only did the Committee take testimony from bankers and officials from various agencies, but statements were also made by investment bankers, mortgage bankers, representatives of the securities industry, the housing industry, the insurance industry, small businessmen, the AFL-CIO, the National Consumers League, the Consumer Federal of America, the American Association of Retired Persons, and state bank supervisors. The Committee has heard from large institutions and small institutions, whose views often are antithetical. By hearing the testimony from representatives of many diverse groups, the Committee has tried to arrive at a compromise that offers some benefits to all participants in the banking industry.

Economic, social, and technological developments are the forces bringing about change in the banking industry. Congress' role is to ensure that these forces do not affect some groups disproportionately and to maintain a safe and sound framework for the conduct of the banking business in this country. S. 2851 presents a means for allocating the effects of change across a wide spectrum of the populace, and is offered after consideration of the needs of many groups and individuals.

Redefinition of "bank"

Under current law, a bank is defined in section 2(c) of the BHC Act as any institution, other than an institution insured by the Federal Savings and Loan Insurance Corporation, chartered by the Federal Home Loan Bank Board, or engaged in foreign banking activities, which both accepts deposits that the depositor has a legal right to withdraw on demand (i.e., a checking account) and engages in the business of making commercial loans. This dual-test definition has been used to create the so-called "nonbank bank" loophole whereby a holding company may acquire a subsidiary with a bank charter but, by either not offering demand deposits or not making commercial loans, the subsidiary avoids being defined as a "bank" under section 2(c). The result is that the parent company avoids the activities restrictions of the BHC Act and/or the restrictions on interstate ownership of bank subsidiaries.

Since the BHC Act was enacted in 1956, Congress has changed the "bank" definition on two occasions, in 1966 and again in 1970 when bank holding companies owning only one bank subsidiary were brought under the Act. The 1970 definition—any institution accepting demand deposits and engaged in the business of making commercial loans—is a functional test, designed to cover a broad category of institutions. Prior to that time, the definition depended on how an institution was chartered: in 1956 and in 1966, section 2(c) referred to national banks, state banks, savings banks, and trust companies.

In 1970 a functional "bank" test was deemed more appropriate than relying solely on the type of charter an institution held. The two-part test was designed in 1970 to exempt at least one specific institution whose charter and general characteristics were, and have been, those of a trust company.

After Gulf and Western acquired a relatively small bank in California in 1980, and to terminated the bank's commercial lending activities, approximately fifty additional nonbank banks have been acquired or established by companies in order to engage in depository institution services without subjecting themselves to general activities limitations or the interstate banking restrictions of the BHC Act. Thus, an anomalous situation has developed under which financial service conglomerates (combining insurance, real estate and/or securities activities) and retail merchandising companies have opened retail-oriented consumer banks at the same time that bank holding companies remain confined to a limited-product-line and limited geographical market expansion opportunities.

The growth of such entities has provided consumers with new outlets for financial services but it has been accomplished beyond the traditional framework of the BHC Act. If left unchecked, nonbank banks would be a system of financial intermediaries chartered as banks with deposits covered by federal insurance but whose parents would not be subject to the restrictions and requirements of the BHC Act, under which the traditional banking organizations have operated for almost three decades.

Because of the unique characteristics of banks and the Congressional policy to permit companies owning banks to engage in only

limited nonbanking activities, the Committee believes it necessary and appropriate to redefine "bank" in order to preserve the general separation of banking from other forms of commerce. The BHC Act was designed to accomplish this objective, to maintain impartiality in the granting of credit, and to prevent conflicts of interest, undue concentration of financial resources, unsound banking practices, and excessive risk to the financial system. The redefinition is a further affirmation of that general policy.

Under section 104(a) of the bill, the term "bank" under section 2(c) would be defined to be:

(a) an FDIC insured bank;

(b) any institution that accepts transaction accounts (including checking accounts, NOW accounts, and other third party payment accounts) and is engaged in the business of making commercial loans; or

(c) any FDIC-insured, state stock savings bank in existence as of October 15, 1982 which is engaged in the business of making commercial loans and is not a Federal savings bank on the date of enactment.

This test covers FDIC-insured banks and also has a functional test (transaction accounts and commercial loans) for non-FDIC insured institutions.

The third part of the test applies to a specific category of state stock savings banks—those in existence as of the date of enactment of the Garn-St Germain Act which are not Federally chartered on the date of enactment of this legislation. The purpose of this is to provide a framework for the regulation of the parent of certain state savings banks which, because of their commercial lending activities, are more like commercial banks than thrift institutions.

For purposes of determining what is a commercial loan under this definition, the bill contains a provision describing investments which are not deemed to be commercial loans. These include personal loans, real estate loans, commercial paper investments, and purchases of installment loans. This reflects the Committee's opinion that the Federal Reserve Board's recent regulatory definition of commercial loan, intended to promote consistent regulatory treatment of depository organizations, is not necessary in light of the redefinition of the term "bank" included in this bill.

For purposes of determining when a non-FDIC insured institution or a savings bank described in the "bank" definition is "engaged in the business of making commercial loans", the bill provides that such institutions are not deemed to be so engaged if they have no more than 10 percent of their total assets in commercial loans. In light of the fact that state-chartered, non-federally insured institutions are covered by this provision, the Committee believes the 10 percent test is an appropriate standard to apply when requiring a parent of such an institution to register as a bank holding company under the BHC Act.

The 10 percent test is appropriate for the savings banks in light of the commercial lending and investment powers provided for federal thrift institutions under the Home Owners Loan Act. These include 10 percent of assets in direct commercial lending, 10 percent in leasing, and a 30 percent category for consumer financing and inventory and floor planning to accommodate such consumer

credit. Thus, while state laws may vary, the 10 percent test for BHC Act purposes is a reasonable standard to utilize in defining a savings bank as a bank or a thrift. Under section 107(c) of the bill, a parent of a savings bank described in this section which has 10 percent or less of its assets in commercial loans will be subject to the Savings and Loan Holding Company Act.

Exemptions

Under present law, thrift institutions insured by FSLIC or chartered by the Bank Board, Edge Act corporations, and certain foreign organizations are excluded from the definition of a "bank". The bill expands this to exclude trust companies from the definition and to exclude any "insured institution" under section 408 of the National Housing Act, a more descriptive term than FSLIC insured or Federal Home Loan Bank Board chartered thrift. The term "insured institution" is used throughout the Savings and Loan Holding Company Act and, under section 107(b) of the bill, is used to define institutions for purposes of the qualified thrift lender test.

The trust company exemption is designed to cover traditional trust companies engaged in fiduciary and similar activities. Allowance is made for occasional deposit taking but only where necessary for the fulfillment of trust functions and only as an incidental part of its trust business.

There are a few trust companies established and operated by securities exchanges. These are primarily custodial and clearing institutions that take no deposits, and are not eligible for FDIC insurance. Therefore, they would clearly be exempted by the "bank" definition as well as by the trust company definition.

Grandfathered activities

The original Administration-Treasury bill on financial reform, S. 1609, was introduced on July 12, 1983 and has a grandfather date of July 1, 1983 for companies owning nonbank banks. That date was used in S. 2181 and is also in S. 2851. The Committee's oversight hearings on the financial services industry in the spring of 1983 and the introduction of moratorium bills soon after the conclusion of those hearings form the basis for notification of Congressional intent to deal with the nonbank issue and make July 1, 1983, an appropriate grandfather date.

Section 104(c) generally provides that any company which controlled a nonbank bank before July 1, 1983 and was not a bank holding company may retain such depository institution and will not be deemed to be a bank holding company unless such company (a) acquires an additional bank or thrifty institution, (b) allows its nonbank bank to both accept demand deposits and make commercial loans (which is the current definition of a "bank"), or (c) commences activities of a financial nature which were not engaged in by the company on June 27, 1984 and are not authorized for bank holding companies under section 4 of the BHC Act. The language in (c) above is substitute language offered as an amendment during the Committee mark-up by Senator Cranston and agreed to by a vote of 14 to 3.

Under this grandfather provision, a company which acquired a nonbank bank prior to July 1, 1983, may expand its nonfinancial activities. With respect to the financial activities in which it was engaged on June 27, 1984, it could continue to perform these activities and expand and engage in other aspects of these activities, either de novo or by acquisition, without becoming a bank holding company, and without being subject to the procedural, approval or other requirements of the BHC Act. For example, an insurance company with a grandfathered nonbank bank would be free to acquire a manufacturing company. However, such an insurance company could only commence new financial activities in which it was not engaged on June 27, 1984, the date of the Committee's markup, to the extent that those financial activities are permissible for a bank holding company under section 4 of the BHC Act. Thus an insurance company with a grandfathered nonbank bank could only expand into new insurance lines to the extent permitted under Title VI of the Garn-St Germain Act (codified in section 4(c)(8)).

Overall, the grandfather provision would restrict the future diversification within the financial services area by companies covered under the grandfather provision, but it would not restrict or limit future diversification into activities that are not financial in nature.

The term "financial nature" is not defined in the bill and is left open because of the need to ensure that it is flexible enough to include financial products and services which will be developed in the future. The Committee leaves to the Federal Reserve the task of determining whether specific activities are of a financial nature, but this provision is intended to cover general financial services categories, such as securities, insurance and real estate activities.

Specific activities which the Federal Reserve has determined, under past interpretations, are not permissible under section 4(c)(8) include real estate brokerage, general management consulting, and underwriting property and casualty insurance.

The Committee also leaves to the Federal Reserve Board the task of determining the scope of a grandfathered activity, recognizing that the Board has been making similar interpretations under the grandfather provisions of the BHC Act Amendments of 1970.

The effect of the financial activities restrictions would be to equalize the future treatment of companies covered by the grandfather provision with that which has been accorded to bank holding companies under section 4(c)(8) of the BHC Act.

This grandfather provision was further revised by an amendment offered by Senator Lautenberg, and agreed to without objection, to ensure that a company which controlled a bank and was a bank holding company prior to July 1, 1983, and which also acquired a nonbank bank prior to that date, would be eligible for comparable grandfather treatment as institutions owning nonbank banks which were not bank holding companies prior to July 1, 1983. In approving these provisions, the Committee recognized that such companies which owned limited purpose banks are already bank holding companies by virtue of their control of small community commercial banks (with regard to which they already have an exemption under section 4(d) of the BHC Act). The Committee

wishes to make clear that the Lautenberg amendment also applies equally to these companies.

The Committee intends that neither the redefinition of bank nor any other provison of the Financial Services Competitive Equity Act shall affect any exemptions which such a bank holding company has been granted under current law in order to permit it to maintain control of a bank. Thus, an existing bank holding company may continue to own and control an institution which became a bank by virtue of the redefinition without losing any existing exemption with respect to another depository institution it already controls.

In addition, the Committee intends that the phrase in the Lautenberg amendment, "existing subsidiary bank", refers to an institution which became a bank as a result of the redefinition of "bank" and does not include an institution which is a bank under existing law and is lawfully owned by a bank holding company. Similar language in the Cranston amendment is also intended to refer to an institution which became a bank as a result of such redefinition.

The Federal Reserve Board is provided with discretionary authority to terminate the grandfather privileges under section 104(c), including requiring any company owning a nonbank bank to register as a bank holding company, or requiring the parent of a nonbank bank to terminate any activity, if such action is necessary to prevent undue concentration of resources, unfair competition, conflicts of interest, unsound banking practices or is in the public interest. All but the last element are standards presently included in section 4(c)(8) regarding Federal Reserve Board review of applications under that section. As such, there is a body of existing law which may be used by the Federal Reserve Board in making any determinations with respect to the grandfathered status of companies owning nonbank banks. The inclusion of a public interest standard is to ensure that, if there is some compelling public purpose reason other than the specific standards described above, the Federal Reserve may act to limit or terminate a company's grandfathered status.

With regard to a company which acquired a nonbank bank between July 1, 1983 and the date of enactment of the Financial Services Competitive Equity Act, the company would have to divest the bank or become a bank holding company and divest or terminate any activities which are not permissible under the BHC Act.

Any company which becomes a bank holding company after the date of enactment by virtue of its acquisition or establishment of a bank, as defined in amended section 2(c) of the BHC Act, would have to divest or terminate any activities which are not permissible for bank holding companies under the BHC Act within two years. This two year requirement is similar to the two year divestiture period included in the original BHC Act.

In addition to the regulatory framework applicable to activities of companies owning nonbank banks, section 104(b)(2) of the bill imposes restrictions on companies which have utilized the nonbank alternative to avoid the Douglas Amendment restrictions on interstate banking operations of bank holding companies. The Douglas Amendment, section 3(d) of the BHC Act, generally authorizes

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holding companies to acquire a bank across state lines only if the state in which the bank to be acquired is located specifically authorizes such acquisitions. Section 104(b)(2) of the bill provides that a company which acquired or established a nonbank bank on or after July 1, 1983, across state lines which would have been impermissible under section 3(d) of the BHC Act, would have to divest the bank within 6 months after enactment of the Financial Services Competitive Equity Act.

Banking organizations securities activities

Fifty-one years ago, Congress enacted the Glass-Steagall Act to separate commercial banking from many investment banking activities in the belief that the combination of these activities as then conducted contributed to the virtual collapse of the nation's financial system in the early 1930's. In addition to the Glass-Steagall Act, Congress enacted laws in 1933 and 1934, such as the Securities Act, the Securities Exchange Act, the Home Owners Loan Act, and the Federal Deposit Insurance Act, which established much of the statutory framework under which the nation's financial organizations have operated and been supervised. Since that time, the nation has benefitted from a basically safe, sound and diverse financial system.

The Glass-Steagall Act was aimed at abuses which had occurred during the 1920's and early 1930's from bank involvement in securities activities. Congress was concerned that banks would experience losses from investing funds in speculative securities and that conflicts of interest wold arise if a bank had an investment interest or underwriting interest in securities. Specific concern was directed toward practices indicating that some banks had misused their trust departments to purchase excessive holdings of undesirable securities.

While Congress generally separated commercial banking from investment banking in 1933, it did authorize, and has expanded through the years, limited securities activities for banks. As noted by the Supreme Court in its recent decision in *Securities Industry Association* v. *Board of Governors of the Federal Reserve System*, No. 82-1766, pp. 8-9. (June 28, 1984), the principal emphasis of Congressional concern in 1933 was on bank underwriting and dealing in corporate activities. The exceptions which Congress has made to the general prohibition of the Glass-Steagall Act have been in the area of securities activities, such as underwriting and dealing in public securities (such as general obligation bonds and certain revenue bonds issued by state and local governments) and in securities brokerage services, which have been deemed to not present the same problems which the Act was designed to prevent.

In light of the history of the Glass-Steagall Act and of the financial system today, section 104(a) of the bill authorizes depository institutions, through a separate subsidiary of a holding company, such a subsidiary termed a Depository Institutions Securities Affiliate ("DISA"), to engage in certain additional securities activities. These include underwriting and dealing in revenue bonds, mortgage-backed securities and commercial paper. The Committee believes that such activities, subject to the overall framework of the BHC Act, to specific regulation by the Securities and Exchange

Commission and carefully circumscribed by restrictions on dealings with affiliates, are consistent with the principles and purposes of the Glass-Steagall Act.

In addition to the new activities, a DISA may also engage in any securities and securities-related activities that a national bank is not prohibited from conducting. Thus, a DISA may underwrite and purchase or sell U.S. government obligations; obligations that are issued by, or backed by the full faith and credit of, a state or political subdivision with general taxing powers; and other obligations specifically listed in Section 24 (Seventh). A DISA may also engage in the business of acting as agent for customers in the purchase or sale of securities (generally described as discount securities brokerage) and may deal in foreign exchange, certificates of deposit, and banker's acceptances, among other instruments.

Revenue bonds.—While a DISA would be authorized to underwrite and deal in obligations issued by a State, any political subdivision thereof, or any agency or instrumentality of either, including revenue bonds not backed by the general taxing power, the bill would prohibit a DISA from underwriting industrial developments bonds, as that term is defined in Section 103(b)(2) of the Internal Revenue Code unless (i) the payment of principal and interest on the industrial development bond is backed by a pledge of the full faith and credit of a State, territory, possession of the United States, any political subdivision of the foregoing, or the District of Columbia, or (ii) the governmental issuer, or governmental unit on behalf of which the obligations were issued is considered to be the sole owner, for federal income tax purposes, of the facility or property financed with the proceeds of the industrial development bonds.

Thus, the bill provides explicit authority for a DISA to underwrite or purchase and sell most revenue bonds and similar obligations issued by state and local government units, a category of obligations that includes many water and sewer system, mass transit, and public power bonds that are repaid principally from user fees. The exception to this authority is certain industrial development bonds used to finance a facility against which a private entity claims a depreciation deduction or tax credit.

The Glass-Steagall Act has been interpreted as prohibiting banks from underwriting or purchasing and selling governmental obligations that are not backed by the full faith and credit of an issuer with general taxing powers. In 1933, when revenue bonds represented an insignificant amount of all state and local obligations, this exclusion of the competitive impact that banks could offer was not significant. That situation has changed dramatically. In 1982, revenue bonds accounted for 73 percent of the municipal market. As a result, banks and their affiliates were excluded from competing in the market for approximately $35 billion in state and local issues in that year.

Not surprisingly, the marketplace for underwriting revenue bonds is more concentrated than is the market for underwriting general obligation bonds, in which banks can and have competed safely and fairly for more than 50 years. In the revenue bond market, the ten leading underwriters (all nonbank broker-dealers) controlled almost one half of the market in 1982, up from 43% in

1977. By contrast, in the general obligation bond market, the share of ten leading underwriters (banks and nonbanks) fell from 32% to 29% during that same period.

The expanded authority contained in the bill will result in significant benefits to governmental issuers of these obligations and thus to their residents and taxpayers who must ultimately bear the cost of public borrowing. DISA's will bring increased competition to the underwriting aspects of this market and will enlarge and enhance the liquidity of the secondary market. The result of this competition will be lower underwriting spreads and hence higher proceeds for the issuer. Moreover, the enhanced liquidity and the expansion of the market through customers of the DISA will result in lower interest rates for governmental issuers. Both of these factors will reduce the cost of borrowing for state and local governmental units, to the ultimate benefit of its taxpayers, without any increased cost or loss of revenue to the Federal government.

Among the supporters of the revenue bond provision are the National Governors Association, the National League of Cities, the Municipal Finance Officers Association, the Government Finance Officers Association, and the National Conference of State Legislatures. The National Governors Association, in a letter dated June 12, 1984, to Chairman Garn, signed by Governors Lamar Alexander and Michael Dukakis, Chairman and Vice Chairman, respectively of the Association's Committee on Economic Development and Technology Innovation, indicated that Association's long support for "efforts to increase competition for underwriting revenue bonds in view of the potential of this initiative to reduce significantly the cost of revenue financing".

With regard to risk, the Committee believes there is no undue risk to the safety and soundness of the affiliate depository institution in authorizing DISA's to underwrite and deal in these obligations. Since 1933, Congress has amended the Glass-Steagall Act at least 15 times to make certain otherwise ineligible public obligations bank-eligible. Thus, banks today underwrite obligations of the Asian Development Bank, the TVA, as well as revenue bond obligations issued by state and local governments for housing, university or dormitory purposes. In addition, the Senate passed legislation in 1967 and 1974 which authorized banks to underwrite and deal in revenue bonds. Banks have underwritten and purchased or sold these obligations for many years without adversely impacting the bank's safety and soundness. In fact, because of the exceptions which Congress has enacted, in 1982 banks were eligible to underwrite about 40% of all municipal revenue bonds. Thus, the Print merely expands on this experience by authorizing the DISA to underwrite or deal in these additional, similar obligations.

Mortgage related obligations.—The bill authorizes DISA's to underwrite and deal in promissory notes secured by real estate mortgages, participations in such notes, and "mortgage related payment bonds" secured by promissory notes secured by real estate or participation interest in such notes. Mortgage related payment bonds are defined to mean obligations, with or without recourse, that provide for the payment of principal on the basis of payments or reasonable projections of payments on notes secured by real estate and that are rated in one of the four highest rating categories by a na-

tionally recognized rating organization. This authorization will permit a DISA to underwrite or deal in what are commonly referred to as mortgage related obligations.

Encouraging the provision of capital to finance the housing needs of this country has always been a matter of significant Congressional concern and interest. Recent estimates by the Federal National Mortgage Association ("FNMA") suggest that $1.6 trillion or more will be needed to finance home mortgages between now and 1990. Much of this amount (approximately one-half according to FNMA) will be financed through the origination of mortgages and their resale into the secondary market. The purchase of a single mortgage by an investor may be unattractive, however, because of the risk of repayment prior to the stated maturity date. The pooling of many individual mortgages and the sale of participations in those pools enhances the attractiveness of such purchases to investors because the pool's diversification spreads the risk and provides greater actuarial consistency of payment and repayment.

Depository institutions, both thrift organizations and banks, and their holding company affiliates have long been active participants in providing for the country's housing needs. Depository institutions originate mortgage loans directly either for their own portfolio or for eventual resale to an institutional investor.

But depository institutions actively provide real estate financing in other ways as well. When it was enacted, the Glass-Steagall Act expressly reserved the power of national banks to sell obligations evidencing loans on real estate. 12 U.S.C. 378(a)(1). The Glass-Steagall Act also expressly permits banks to underwrite, deal in, or purchase for their own account obligations issued by FNMA, the Government National Mortgage Association, or the Federal Home Loan Mortgage Corporation—all government-related agencies which issue securities based on pools of residential mortgages. In addition, as noted above, banks are specifically permitted to deal in and underwrite non-general obligations issued by a State or local governmental unit for housing purposes. The provision of the bill authorizing DISA's to underwrite or purchase and sell mortgage backed securities merely clarifies that these affiliates of depository institutions can continue to occupy an integral role in this evolving method of real estate financing.

Commerical Paper.—The bill also expressly permits DISA's to underwrite, deal in, sell, and distribute (both as principal and as agent) commerical paper issued by any person. Issuing commercial paper has become a standard means by which corporations raise short-term and operating funds. These notes are purchased by corporations and institutional investors with excess funds on a short term basis. In this manner, commercial paper serves as a substitute for short term borrowings by the issuer and for deposits by the purchaser.

The authority contained in the bill will permit a DISA to purchase and sell commercial paper for its own account or arrange for the purchase of commercial paper by third parties. The evolution of our financial markets makes this explicit authority with respect to commercial paper useful if depository institutions are to maintain their role as intermediaries in providing for the short term credit needs of American business.

The authorization contained in the bill for a DISA to underwrite commercial paper does not bear on the legality of a depository institution without a DISA engaging in commercial paper activities. Thus, it has no direct impact on the Supreme Court's recent decision in *Securities Industry Association* v. *Board of Governors of the Federal Reserve System*, No. 82-1766 (June 28, 1984), which held that third-party commercial paper is a security, not a loan, for purposes of the Glass-Steagall Act and remanded to the lower courts the question as to whether the commercial paper agency activity of Bankers Trust constitutes "underwriting" within the meaning of section 16, or "the business of issuing, underwriting, selling or distributing" within the meaning of section 21, of the Glass-Steagall Act. However, if a depository institution holding company establishes a DISA and engages in, for example, the newly authorized revenue bond activities, it will have to transfer both its principal and as agent third-party commercial paper activities to the DISA.

Establishment of DISA

The bill requires that the newly authorized securities activities be conducted directly by a depository institution holding company or in a depository institution securities affiliate ("DISA"). A DISA is a non-depository affiliate of a commercial bank or a thrift institution that (1) engages in any of the bill's newly authorized securities or securities-related activities; and (2) is a broker-dealer within the meaning of the Securities Exchange Act or an investment advisor within the meaning of the Investment Advisors Act of 1940. This definition means that securities activities of bank affiliates (including those engaged in by Edge Act and Agreement corporations and their subsidiaries) outside the United States would not be subject to the requirements of the bill.

Acquiring or organizing a DISA would be subject to review under the BHC Act or the Savings and Loan Holding Company Act, as appropriate. A bank holding company would have to give the same prior notice to the Federal Reserve Board to engage in the activities of a DISA as would be require to engage in Section 4(c)(8) activities under the bill. Savings and loan holding companies would be subject to a similar prior notice requirement with the FSLIC. Either regulator will consider the criteria set forth in amended Section 4(c)(8) in determining whether to disapprove a notice submitted by a holding company. In addition, of course, a DISA would also have to meet the SEC's requirements for registering as a broker-dealer or an investment advisor if its activities so warranted.

The requirement that the newly authorized activities be conducted in a subsidiary separate from the depository institution has several implications. The DISA will not be exempt from the provisions of the Securities Exchange Act (as is a bank) and thus, will be subject to regulation by the SEC. Because the DISA will be a registered broker-dealer (or municipal securities dealer), the SEC would be the appropriate regulatory agency for enforcing a DISA's compliance with the statutes and regulations governing transactions in municipal securities.

The fact that the bill requires the establishment of a DISA to conduct securities activities, rather than permitting the institution

itself, refutes, in the Committee's view, the arguments that depository institutions have unfair competitive, regulatory or tax advantages, or potential conflicts of interest that securities firms do not have, in conducting securities activities. The DISA will be a separately-capitalized corporation, its securities activities will not be for the account of the depository institution, nor will they put the depository institution's assets at risk; the DISA will be subject to the same rules that securities firms are subject to; and the DISA, as a separate entity, will not be able to draw upon the depository institution for favorable funding or possible tax advantages. The requirement that the new securities activities be conducted in a DISA, therefore, assures fair and vigorous competition in the public interest.

Among other things, the SEC's net capital rule would apply to the DISA. Because the subsidiary must be separately capitalized, the potential riks to the bank holding company's bank subsidiaries is not signficant.

Any DISA that provided all the services a DISA could provide under the bill would be subject to the jurisdiction of the MSRB and would also have to join the NASD and SIPC. DISA representatives would be eligible for one or more of the five seats reserved for bank representatives on the MSRB.

The bill would amend the Glass-Steagall Act to permit the DISA to be affiliated with (but not to be owned by) a depository institution. The DISA and its affiliated depository institution would also be permitted to have overlapping officers, directors and employees. Existing restrictions that prevent such an interlocking relationship between a depository institution and an unaffiliated DISA or other firm engaged in the designated securities activities would continue to apply.

The bill would also override any state law that prohibited an affiliation between a national bank or federally-chartered thrift institution and a company engaged in an activity (such as DISA-eligible securities activities) permitted under the bill. This is almost certainly the conclusion that would be reached in the event of litigation on the issue even without the specific override provision, but the override provision eliminates any question that might otherwise be raised.

One of the goals of the bill is to permit the securities subsidiaries of depository institution holding companies to compete with securities firms in a limited range of businesses. In furtherance of this goal, as already noted, the bill provides that the bank holding company securities subsidiary will ordinarily be subject to the same SEC capital requirements as are applicable to securities firms not owned by bank holding companies.

During the course of the congressional consideration of this legislation, the Federal Reserve Board and other federal banking regulators brought into place capital adequacy guidelines for banks and bank holding companies. In general, these guidelines require the bank and the bank holding company each to maintain a 5 percent ratio of primary capital (as defined) to assets for the very largest bank holding companies, with higher ratios for the smaller bank holding companies. The capital requirements for bank holding companies are higher than the capital requirements for securities

firms. For example, information provided to the Committee shows that in recent years several of the largest securities firms have had capital to asset ratios of 3 percent or less.

The Committee anticipates that the Federal Reserve Board will apply its capital adequacy guidelines in a way that is consistent with both the goal of equality of competition and the objective of safety and soundness (which were recently emphasized in the capital adequancy provisions of the International Lending Supervision Act of 1983). For example, if securities subsidiaries complying with the SEC capital rules were required to have greater capitalization for any given level of securities subsidiary activity than their competitors, this could put bank holding companies at a competitive disadvantage as compared to securities firms and others—including thrift holding companies who are being granted identical powers under the bill—that are not subject to similar holding company capital rules. Conversely, a holding company subsidiary that was undercapitalized relative to its nonbank affiliated competitors could have a competitive advantage.

In general, the Committee believes it would be appropriate for the Board of assess compliance with the capital adequacy guidelines by a bank holding company without considering the assets or capital in the securities subsidiary, so long as the securities subsidiary is itself in compliance with the applicable SEC rules. Of course, it is intended that the Federal Reserve Board will have sufficient regulatory authority in unusual cases to require greater capital if the size of the securities subsidiary, or its financial condition, or other factors (including limitations on the level of indebtedness of bank holding companies), makes that necessary in the public interest. The Committee is quite sympathetic with the Board's concern that bank holding companies not simply borrow money to put into a securities subsidiary as capital. The Committee expects that the capital put into securities subsidiaries will be permanent equity capital of the bank holding company and not simply borrowed funds.

Transfer of activities

Under section 104(e) of the bill, no despository institution holding company that establishes or acquires a DISA engaged in the newly authorized activities, could permit any depository institution it controls to conduct certain otherwise permissible, domestic securities activities. The activities in which the depository institution itself cannot engage could be transferred to, and conducted by, the DISA.

The activities that are subject to this transfer requirement are:

the activities specifically authorized by Section 104(e) of the bill;

dealing in or underwriting obligations of the United States;

dealing in or underwriting general obligations of any State or political subdivision;

dealing in or underwriting general obligations specifically listed in 12 U.S.C., sec. 24 (Seventh); and

purchasing and selling securities and stock as agent.

The bill would also permit the Federal Reserve Board to prescribe, by regulation or order, other securities or securities-related activities in which a depository institution may not engage if it is

affiliated with a DISA exercising the new securities powers. Any such activities may also be transferred to the DISA and conducted by it.

The prohibition on purchasing or selling securities and stock as agent is designed to preclude a depository institution from engaging in the business of purchasing and selling securities for the public if the institution is affiliated with a DISA or a holding company engaged in the new authorization activities. A depository institution affiliated with a DISA would continue to be permitted to buy or sell securities for a customer on occasion (e.g., on an accommodation basis) but would be required to transfer its brokerage activities if they are publicly advertised and engaged in on a regular basis, as is the case with discount brokerage activities. (This securities activity was the subject of a legal challenge and was upheld in a recent Supreme Court decision, *Securities Industry Association* v. *Board of Governors of the Federal Reserve System,* No. 83-614, June 28, 1984.)

The transfer requirement does not prohibit a depository institution from engaging in activities that are an appropriate part of the activity of financing the institution or investing its funds. Thus, the purchase and sale of investment securities for the institution's own portfolio and its management activities may continue to be conducted by the depository institution. The bill is also not intended to prohibit traditional custodial or trust activities. Furthermore, advisory activities in connection with private placement of securities would not have to be transferred to the DISA.

The transfer requirement would apply only to those depository institution holding companies that establish or acquire a DISA engaged in the activities newly authorized by the bill. Holding companies that establish or acquire such a DISA would be given one year from the date on which the DISA first engages in the newly authorized activities to accomplish the transfer of activities. A thrift institution with grandfathered activities would be required to move those activities if its holding company or DISA engages in the newly authorized activities.

A depository institution whose holding company does not establish or acquire a DISA can continue its existing permissible securities activities in the depository institution. The bill also specifically authorizes the transfer of permissible securities activities back to the depository institution if the DISA no longer engages in the newly authorized activities.

Reports and examinations

The bill amends the BHC Act to minimize the regulatory overlap between the Federal Reserve Board and the Securities and Exchange Commission with regard to bank holding companies and their subsidiaries engaged in the securities business. Thus, the bill authorizes the Federal Reserve Board to require periodic reports to monitor whether bank holding companies and their affiliates are complying with applicable rules and regulations. But the bill also directs the Board to accept, unless it specifically determines that a lesser requirement is appropriate, the following:

for companies subject to the reporting requirements of Section 17 of the Exchange Act (e.g., registered broker-dealers),

the same information and at the same time as that required by the SEC under that section;

for all other companies, the same information (on a quarterly basis) as would be required under Section 13 of the Exchange Act for companies in similar lines of business if the company were subject to those reporting requirements.

The bill authorizes the Federal Reserve Board to require additional reports and information in particular circumstances only if necessary to fulfill the Board's responsibilities under the BHC Act.

Under the bill, a subsidiary of a bank holding company (including a DISA) owned by a bank holding company also remains subject to examination by the Federal Reserve Board. The bill directs the Board to minimize, insofar as possible, the scope and frequency of examinations of non-bank subsidiaries by relying on reports of applicable regulatory agencies, including the SEC with respect to a DISA, and by focusing, to the extent feasible, on the activities of the non-banking subsidiary that could have a material adverse effect on the safety and soundness of the subsidiary bank. In this manner, it is intended that duplication of examination will be eliminated and the burden of dual regulation on DISAs will be reduced.

Restrictions on transactions with affiliates

Section 105 of the bill adds a new section, 23B, to the Federal Reserve Act in order to restrict transactions between an insured bank and its affiliates. These restrictions are in addition to the numerical and other limitations imposed on affiliate transactions under section 23A of the Federal Reserve Act. Since section 23B is aimed primarily at the new securities authorities, the Federal Reserve Board is expected to utilize its discretionary authority to exclude subsidiaries engaged in existing nonbank activities.

Under the new section 23B, a bank could engage in certain specified types of transactions with an affiliate only if the terms and conditions are substantially the same as those prevailing at the time for comparable transactions with unaffiliated companies. A bank and an affiliate would be prohibited from advertising or entering into any agreement suggesting that the bank is in any way responsible for its affiliate's obligations. Moreover, a bank and a securities affiliate would be prohibited from using the same name.

Specific restrictions and limitations are also imposed on a bank's purchase of securities from an affiliate for the bank's own account or the account of a customer. When a securities affiliate is a principal underwriter of securities, a bank affiliate may purchase such securities during the underwriting only if, prior to the initial public sale of the securities, a majority of the bank's outside directors approve such a purchase. In addition, a bank may not purchase as fiduciary any securities from any affiliate unless such purchases are permitted by the instrument establishing the fiduciary relationship, by court order or by law of the state under which the trust is administered.

Formation of bank holding companies

The new securities powers included in the bill may only be exercised directly by a bank holding company or through a separate

subsidiary of a bank holding company. This would be a roadblock to many banks which are independent and do not wish to apply under existing procedural requirements to the Federal Reserve to form a holding company and obtain its approval under the BHC Act.

In order to minimize the regulatory burdens associated with a holding company formation, especially for smaller institutions, sections 102 and 104(b)(1) of the bill provide streamlined procedures for purposes of the Securities Act of 1933 and the BHC Act. Section 102 provides an exemption from the registration requirements of the Securities Act for the issuance of shares in connection with a simple reorganization in which the company becomes the parent of a bank. Section 104(b)(1) amends the BHC Act to provide a simplified 30 day notification process for the formation of a bank holding company where the person or persons forming the holding company maintain substantially the same proportional interests in the holding company as they had in the bank.

Section 4(c)(8) of the Bank Holding Company Act—Permissible nonbanking activities of bank holding companies

"Closely related" test.—Under section 4(c)(8) of the BHC Act, the Federal Reserve Board may authorize, by order or regulation, bank holding companies to engage in activities "so closely related to banking or managing or controlling banks as to be a proper incident thereto". In determining whether an activity is a proper incident, the Board is required to consider whether a proposed activity can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interest, or unsound banking practices.

In applying the "closely related" test, the Federal Reserve Board has looked at what banks have done, not what they may do in the future. The principal explanation of what is closely related to banking is contained in *National Courier Association* v. *Board of Governors*, 516 F.2d 1229 (D.C. Cir. 1975). In that decision, the Court set out the following three general standards regarding what is closely related to banking:

(1) Banks have generally provided the proposed services;

(2) Banks generally provide services that are operationally or functionally so similar to the proposed services as to equip them particularly well to provide the proposed services; and

(3) Banks generally provide services that are so integrally related to the proposed services as to require their provision in a specialized form.

Under this general standard of section 4(c)(8), the Federal Reserve has authorized as "closely related" seventeen different activities, including operating trust companies, data processing of financial information, performing real estate apprisals, and offering discount securities brokerage services. Activities not permitted under existing interpretations of section 4(c)(8) include general management consulting, underwriting mortgage guaranty insurance, general property management services, real estate brokerage, and real estate development. As the Supreme Court has noted in *Securities*

Industry Association v. *Board of Governors of the Federal Reserve System* (Schwab), No. 83-614 (June 28, 1984), however, the Federal Reserve is not limited to the *National Courier* test. In the *Schwab* case, the Court stated:

> Indeed, the relevant statutory language does not specify any factors that the Board must consider in making ("closely related") determinations. The general nature of the statutory language, therefore, suggests that Congress vested the Board with considerable discretion to consider and weigh a variety of factors in determining whether an activity is "closely related" to banking.

As presented at the mark-up, Section 104(d) of the bill proposed expanding the section 4(c)(8) test by adding two tests to the closely related standard for purposes of determining permissible nonbanking activities for bank holding companies under the BHC Act. With these additions, the Federal Reserve would have been able to authorize nonbanking activities which are (a) closely related to banking, (b) of a financial nature and designed to enable bank holding companies to adjust to technological innovations in the provision of banking or banking-related services, or (c) of a financial nature and substantially identical to products or services offered by nonbanking concerns which are competitive with products or services provided by banks. During the mark-up, Senator Proxmire offered an amendment to revise this language in order to preserve the "closely related" test, eliminate the reference to activities of a financial nature, and direct the Federal Reserve to consider technological and other changes when rendering opinions under the closely related test. The Proxmire amendment, agreed to without objection, preserves the "closely related" test and requires the Federal Reserve in interpreting that standard, to "take into account technological or other innovations in the provision of banking or banking-related services". The intent is to ensure that the Federal Reserve Board considers the effect of technological and other changes in banking in administering the closely related test.

In addition to altering the "closely related" test, the bill specifically authorizes bank holding companies to acquire thrift institutions as a "closely related" activity. Limitations placed on such acquisitions include applying the branching and interstate acquisition restrictions of the McFadden Act and of the Douglas Amendment, respectively, to thrifts acquired by bank holding companies. However, branches already opeated by a thrift would be permitted to be retained after an acquistion by a bank holding company.

Procedures.—Perhaps almost as significant as the closely related test are the rather cumbersome procedures governing the present section 4(c)(8) application process. Under existing law, a bank holding company must file an application to engage in a nonbanking activity and await Federal Reserve review and final action. Although designed to take 91 days, this process often takes longer and, if hearings are requested or court challenges are made by an opponent of an approved applications, the process may take years to resolve. Contrasted with this are other corporate participants in the same nonbanking activities which may enter or leave many of these businesses without reference to any regulatory process.

In order to promote competition, facilitate bank holding company entry into permissible nonbanking activities, and ensure an adequate level of regulatory control over the process, section 104(d) of the bill provides for streamlined application and judicial review procedures (which are also applicable to securities activities under new section 4(c)(15)). These include a 60 day notice period after which a holding company would be authorized to engage in the permissible activity. The Federal Reserve Board is required to issue orders setting forth the reasons for any disapproval or determination not to disapprove a notice under section 4(c)(8). In addition, no notice would be required by a bank holding company for additional offices or changes or office locations for activities previously authorized for the same holding company.

Judicial review of Federal Reserve Board orders under these revised standards may occur but only on questions relating to the Board's finding that the activity is permissible and to the Board's findings regarding the issue of unfair competition.

Limitation on Powers of Bank Holding Company Subsidiaries.—Section 104(g) of the bill provides that a state bank subsidiary of a bank holding company may engage in activities outside the bank's home state only to the extent that such activities are permissible for bank holding companies under section 4(c)(8) of the BHC Act. This would permit state bank subsidiaries of bank holding companies to engage in a broader range of activities if permitted under state law, even if such activities may not be permissible for bank holding companies; provided those activities are limited to the authorizing state. (This is limited by the provisions of the Dodd amendment described below). The provision clarifies that such activities, if conducted outside of the authorizing state, are prohibited by the BHC Act. Thus, the home state activities of a state bank would not be affected. Moreover, the provision would not limit state banks from engaging outside the authorizing state in the traditional deposit, lending, trust and similar activities of a bank, activities such as national banks may perform under the National Bank Act, and that would be "banking" activities under section 4 of the Act. The limitation also would not affect any activities of a state bank which is not within a bank holding company system. This provision is not intended to limit the applicability of the nonbanking provisions of the Act to bank holding companies and their subsidiaries or to otherwise affect the coverage of the Act.

During the Committee's mark-up, Senator Dodd offered an amendment to add a provision to the bill which would specifically emphasize that all subsidiaries and affiliates of a bank holding company, including state bank subsidiaries and their affiliates, are subject to the insurance activities prohibitions and restrictions of Title VI of the Garn-St Germain Act. The amendment was agreed to by a vote of 10 to 8 and inserted in section 104(d) of the Print.

Title VI of the Garn-St Germain Act amended section 4(c)(8) of the BHC Act expressly to prohibit bank holding companies from engaging in most insurance activities. Since the enactment of Garn-St Germain, questions have arisen concerning whether the insurance limitations contained in Title VI apply to state-chartered banking affiliates of bank holding companies in circumstances where the laws of the chartering states are more permissive. The

inclusion of the amendment in section 104(d) specifies that such insurance restrictions apply to bank and other affiliates and all subsidiaries of a bank holding company.

No other changes are made to the insurance provisions of the Garn-St Germain Act and all of its exceptions and permitted activities are continued.

Sections 104(d) and (g) are necessary because of a provision in the Federal Reserve Board's regulations authorizing subsidiaries of banks to engage in any activity authorized under state or federal law for banks to engage in directly. 12 C.F.R. section 225.22(d). These two sections overturn the Federal Reserve Board's regulation to the extent that the regulation authorizes banks and subsidiaries of banks to engage in insurance activities prohibited under Title VI of the Garn-St Germain Depository Institutions Act of 1982 and in other nonbanking activities engaged in outside the authorizing state to the extent that they are prohibited for bank holding companies.

Qualified thrift lender

Congress has long been committed to a healthy housing industry and to a financial institution structure to provide adequate long term home mortgage financing at reasonable rates for the American people. One of the mainstays of that commitment to housing has been the legal structure that Congress established in 1933 with the Federal Home Owners Loan Act, which established the Federal Home Loan Bank Board System and the Federal Savings and Loan Insurance Corporation. Another is the long history of attention and concern Congress has had for the thrift industry.

As the "nonbank bank loophole" came into being, Congress has been forced to reconsider what regulations and requirements it would place on bank holding companies. In its efforts to close the "nonbank bank loophole," it became apparent that one issue that needed to be confronted was the question of what activities a parent of a savings and loan would be permitted to undertake. It appeared very likely that any attempt by Congress to close the "nonbank bank loophole" without establishing more clear and precise standards for the activities of the parent of thrifts would generate a new loophole. If banks were closed off as permissible for ownership for nonbank companies, then thrifts with their increasing similarity to banks would become all the more attractive to such companies as acquisitions. Too much can be made of the similarity, for thrifts still are primarily housing lenders and still have only very limited commercial loan portfolios. Their relationships with depositors tend to be somewhat different as well. Nonetheless, ownership of a thrift would still offer to nonbank companies the advantages of access to the payments system, access to consumer deposits and lending deposit insurance, and some commercial lending authority.

Congress has not historically seen fit to restrict the activities of thrift parents as they have done for bank holding companies through the BHC Act, because thrifts have been restricted to serving the housing needs of the nation and have not typically provided a broad array of services which would be attractive to nonbank companies to offer to consumers. The competitive financial services

market has evolved and changed in the last several years. The Monetary Control Act of 1980 began the process of lifting controls on interest rates and thereby of deregulating the financial services environment. The Garn-St Germain Act continued this process by providing federal thrifts with limited contacylical sources of income to improve their viability as housing lenders. Some states, however, have expanded the asset powers of state chartered thrifts even beyond the expanded powers of federal thrifts.

As a consequence of these shifts in the financial services marketplace, and of this bill's attempt to close the nonbank bank loophole, the need arose to make certain that thrifts engaged in activities that benefited and were related to our national policy objective of providing a plentiful supply of housing finance at reasonable rates. Thrifts which are not engaged in and committed to residential related lending become more like banks and consequently stand in need of being regulated equivalently to banks, and this is true most importantly with respect to the parent companies of thrifts. The bill imposes restrictions on the parents of thrifts where the thrift fails to meet the standards the bill establishes for qualified thrift lenders.

Under section 107(b) of the bill the qualification standards for a qualified thrift lender are that a savings institution, defined as any "insured institution" under the National Housing Act, portfolio must have at least 60 percent of its asset portfolio invested in residential related lending. This includes mortgages, mortgage backed securities, real estate used in the business and a credit of up to ten percent for statutorily required liquidity and/or mortgage banking originations. The credit for liquidity is allowed in recognition of the fact that such liquidity is indeed statutorily required and that many institutions have a need to be liquid in today's rather uncertain interest rate environment, as well as in other times generally. Credit for mortgage banking originations is allowed as part of the ten percent in recognition that such originations are a important part of serving the communities in which those institutions are chartered.

Section 107(b) provides that institutions must not fall below the 60 percent level on an average basis in three out of every four quarters and two out of every three years, so that the overall commitment to housing lending over the long term is the measure of a qualified thrift lender, rather than temporary measurements. A qualified thrift lender may not regain its status as a QTL, once it loses it, for five years, in order to assure that institutions have a substantial incentive to maintain the required level of assets in housing lending.

Section 107(b) subjects holding companies which have a thrift subsidiary that fails to meet the Internal Revenue Code requirements for qualified tax statues (the test currently applied under the Savings and Loan Holding Company Act to determine the activities of a unitary savings and loan holding company will be subject to limitations) to the restrictions on multiple savings and loan holding companies contained in the Savings and Loan Holding Company Act. The restrictions in that act on multiple holding companies are very similar to those on bank holding companies contained in the Bank Holding Company Act. Because the thrift sub-

sidiary of some unitary holding companies will not comply with the standards for QTL's, the bill provides that multiple and non-QTL savings and loan holding companies have the power to engage in any activities that are permissible for bank holding companies under the Bank Holding Company Act. In addition, section 107(b) authorizes QTL unitary holding companies to engage in activities under the Bank Holding Company Act, including the new securities activities.

In addition to the 60 percent test, section 107(b) provides for the special situation of traditional savings banks, found largely in the northeastern states. These institutions are usually FDIC insured and are predominantly state chartered, although some have consented to federal charter in the past few years. Savings banks are distinguished from both banks and thrift institutions because they have traditionally been more heavily involved in mortgage lending than most banks, but have been less so than savings and loans. Their powers under state laws have permitted them to invest in securities to a greater extent than most savings and loan associations and they have also had somewhat broader investment in commercial lending and consumer lending than other thrifts. Consequently because their mortgage portfolios tend to be somewhat below the 60 percent QTL test, the Committee has provided for alternate treatment for such institutions in two major ways.

The first is to provide that a federal savings bank which holds a federal charter on the date of enactment of this bill, but which was a state chartered savings bank prior to October 15, 1982, would be allowed ten years to meet the 60 percent of assets in residential real estate assets test for qualified thrift lenders. Thus, federal savings banks are allowed ten years to bring themselves into compliance, on a graduated scale over that ten year period. The purpose of this ten year phase-in for savings banks is to provide such banks with some lead time to come into compliance, in recognition of the fact that such banks have not been under the same requirements and regulatory regime generally that savings and loans have been over the preceding years and that allowing some time to adapt to the new requirements is a fair method of instituting the new policy. It is also in recognition of the fact that savings banks have long contributed to the housing finance needs of the communities they serve, and that they are still very much contributing to that need by investing in home mortgages and related investment in their communities.

The second ameliorative measure that the bill provides for savings banks is to grant to all institutions which are state-chartered, stock, FDIC-insured savings banks on the date of enactment of this bill status as qualified thrift lenders. It is important to note, however, that if such an institution was in existence before October 15, 1982, it will be classified as a bank for the purposes of the Bank Holding Company Act, and the parent company of that institution will be required to comply with the provisions of that Act, unless it is a savings bank with ten percent or less of its asset in commercial loans. The test again takes cognizance of the fact that savings banks portfolios are structured differently and may have difficulty meeting the 60 percent test, but recognizes also that significant in-

vestment in commercial lending warrants imposing the restrictions of the Bank Holding Company Act.

Grandfather provision.— Section 107(b) authorizes a holding company that was a unitary savings and loan holding company on July 1, 1983, and which does not become a unitary QTL to continue to engage in any activity in which it was lawfully engaged on June 27, 1984, regardless of whether or not savings and loan companies may engage in such activities under Federal law. Activities that are permissible for savings and loan holding companies, however, may be engaged in or expanded only subject to all the requirements, limitations, and conditions of the Savings and Loan Holding Company Act. A grandfathered savings and loan holding company will immediately lose its grandfather privileges if (1) the FSLIC insured subsidiary or FDIC insured state chartered savings institution loses its status under section 7701(a)(19) of the Internal Revenue Code; (2) the grandfathered holding company acquires a commercial bank; or (3) the grandfathered holding company commences any new activities, other than those permissible for savings and loan holding companies under this bill. No grandfather privileges are provided for any company that acquires an insured institution between July 1, 1983 and the date this legislation becomes effective. Furthermore, FHLBB may terminate these grandfather privileges if, after a hearing, it determines that termination is necessary to prevent conflicts of interest or unsound practices or is in the public interest.

The activities listed in subsection 107(b) as permissible for savings and loan holding companies include the following activities that were permissible under prior law: performing management services for a subsidiary FSLIC insured thrift; conducting an insurance agency or escrow business holding, managing, or liquidating a subsidiary FSLIC insured thrift's assets; holding or managing properties of a FSLIC insured thrift subsidiary; and acting as trustee under a deed of trust.

In addition, subsection 107(b) adds the following new permissible activities: the activities of a depository institution securities affiliate in accordance with the limitations contained in the Bank Holding Company Act as provided in subsection 104(e) of this bill [1] activities determined by the Federal Reserve Board, under Section 4(c)(8) of the Bank Holding Company Act, to be closely related to banking; the acquisition of shares of an export trading company in accordance with the relevant provisions of the Bank Holding Company Act (except with FSLIC rather than Federal Reserve Board approval) and subject to any rules or conditions for the conduct of this activity established by the Federal Reserve Board; the acquisition of shares of any FDIC insured bank in accordance with applicable laws including the McFadden Act and the Douglas Amendment; and the activities in which multiple savings and loan holding

[1] For purposes of this subsection, the restrictions set forth in subsection 104(e) that apply to banks and bank holding companies apply to the same extent to thrifts and savings and loan holding companies, respectively. Accordingly, if a savings and loan holding company forms a depository institution securities affiliate, the holding company must transfer all covered securities activities from its subsidiary insured institution(s) to the securities affiliate even where, for example, the subsidiary may have certain grandfather rights with respect to the securities activities conducted by the insured institution through a service corporation.

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companies may engage directly on June 27, 1984, provided that in the case of real estate investment and development, a savings and loan holding company may only maintain its investments lawfully held on june 27, 1984, and make additional investments not in excess of 5 percent of its primary capital.[2] The FSLIC may prohibit or limit, however, a savings and loan holding company from engaging in activities determined by the Federal Reserve Board to be closely related to banking.

It is intended, through this list of permissible activities, that savings and loan holding companies be allowed to engage in the same activities authorized for bank holding companies, except that the FSLIC may either prohibit any activity for savings and loan holding companies or place limitations on their conduct.

The bill provides for approval by the FSLIC of activities which multiple and non-QTL savings and loan holding companies undertake, and of the formation of such companies. Both the procedures are modeled after and are very similar to the procedures the bill sets forth for approval by the Federal Reserve Board of bank holding company activities and of bank holding company formations. The bill also subjects transactions between FSLIC-insured thrifts and their affiliates to sections 23A and 23B of the Federal Reserve Act, under the regulation of FSLIC, just as bank holding companies are subject to such sections under the regulation of the Federal Reserve Board.

Mutual thrift holding companies

Since the bill generally adopts the holding company approach to expanding the powers of banking organizations, a mechanism has been provided for mutual institutions to form holding companies. This will enable mutual institutions, which still comprise the bulk of the thrift industry, to be full participants in the evolving financial services industry.

Section 113 accomplishes this purpose by permitting the mutual corporation to create a wholly-owned subsidiary to function as the insured depository institution. The assets and liabilities of the existing mutual institution are then transferred to the newly chartered subsidiary. The resulting parent corporation, which remains mutual, is authorized to carry on the same activities permitted for multiple savings and loan holding companies (except insurance agency activities) and bank holding companies. Because its activities are limited in this manner, which is generally the activities of a non-QTL holding company system, such mutual organizations are not subject to the QTL tests. Capitalization of the mutual holding company would be accomplished by permitting assets to be retained at the holding company level to the extent that the institution's capital exceeds regulatory minimums.

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[2] The provision concerning real estate investment and development is intended to grandfather a savings and loan holding company's lawful investments in these real estate activities as of June 27, 1984, but to permit additional investments in real estate investment and development only if such additional investments total no more than 5 percent of the holding company's primary capital.

Demand deposit authority of Federal thrifts

Section 108 authorizes Federal savings and loan associations and savings banks to offer demand deposits (checking accounts) to all their customers. Under existing law, Federal thrifts may offer NOW accounts to individuals and non-profit organizations and checking accounts only to businesses with whom they have a credit relationship, as well as certain "billpayer" accounts. In view of the fact that Federal thrifts offer NOW accounts and that most businesses establish checking accounts at institutions from whom they receive loans, the Committee believes it appropriate to remove the restrictions on checking accounts at Federal thrift institutions.

FHLBB advances for QTL's

Section 109 provides that Federal Home Loan Bank member institutions must comply with the requirements for qualified thrift lenders in order to be eligible to receive advances from Federal Home Loan Banks. These advances are permitted to QTL institutions as an incentive to comply with the QTL guidelines and maintain a fundamental commitment to housing related finance. This is consistent in general with the policy which Congress has long espoused and maintained that savings institutions are intended to provide sufficient housing finance in the communities they serve in order to fulfill their responsibilities under their charters and as members of the Federal Home Loan Bank Board. The Bank Board is given the discretion to waive this restriction in appropriate circumstances, such as allowing non-QTL institutions to obtain short-term liquidity funds.

Capital assistance programs extension

The Garn-St Germain Act provided for a Capital Assistance program for under-capitalized banks and thrifts, whereby the FDIC and FHLBB may extend promissory notes to such institutions in exchange for net worth certificates from the institution. The program provides for a graduated scale of amounts of assistance that are permissible according to the net worth level of the assisted institution. The authorization for the program expires on September 1985.

The bill extends the Capital Assistance programs for three years beyond the October 15, 1984 expiration date set forth in Garn-St Germain, to a new expiration date of October 15, 1988.

From the inception of the program in 1982 until the end of the 1st half of 1984 numerous institution's have been assisted under the program. According to agency records as of March 31 the FDIC had assisted 25 mutual savings banks in 3 states—New York, New Jersey, and Pennsylvania, with $386 million in net worth certificates outstanding. As of June 30, 1984, FSLIC had extended $74 million in net worth certificates to 66 savings and loans in 23 states.

The intent of the program was to give the eligible institutions time to restructure their assets and to find a permanent solution to the poor earnings and low capital ratios they were experiencing as a result of the high interest occurring at the time the program was enacted. The bill extends the Capital Assistance program for three

years to insure that savings institutions will have the assistance available for a sufficient length of time to achieve the original purposes of sounder assets, higher earnings and higher capital ratios.

Mortgage securities corporations

In order to provide federally-chartered thrift institutions with an increased ability to fund their mortgage credit operations, section 114 of the bill authorizes such institutions to invest in special-purpose trusts or corporations which would be solely engaged in the business of issuing and servicing mortgage-related securities. Special-purpose subsidiaries are necessary if thrift institutions are to participate fully in emerging methods of providing mortgages to home buyers which involve the issuance of securities products backed by home loans. The steps in the process for constructing a mortgage-backed securities issue involve the contribution of loans (or participation interests in loans) to a trustee or corporate intermediary which sponsors or issues the securities, while receiving monthly payments from homeowners (called "servicing") the loans backing the securities issue. Under existing law, there is no specific provision enabling thrifts to invest in—that is, contribute mortgage assets (or participation interests in mortgages) to—a subsidiary for this purpose.

These new powers are separate from the limitations or prohibitions pertaining to "serviced corporations" of thrift institutions generally. (For example, federal savings institutions may not invest more than 3% of assets in service corporations). The new authority would not be in addition to, and would not diminish, other service corporation-type investment powers possessed by federally or state-chartered institutions.

This mortgage service corporation authority is also separate from the securities affiliate authority in section 107(b) and, therefore, does not contain underwriting or dealing authority. Mortgage securities subsidiaries would be subject to the regulations of the Federal Home Loan Bank Board.

Section 114 also exempts mortgage securities corporations from being included as affiliates for purposes of section 408(d) of the National Housing Act, a provision prohibiting certain transactions between the FSLIC or FDIC-insured savings institution which is part of a savings and loan holding company and other affiliates of the same holding company. For example, section 408(d) prevents a savings institution which is part of a savings and loan holding company from investing in the obligations of an affiliated company. One of the perceived advantages of the emerging products of mortgage securities issuers is the offering of so-called "fast-pay, slow-pay" securities. The savings institution might wish to buy back the first-pay portion of the securities issued by its affiliated mortgage securities corporation as part of a restructuring plan designed to match short-term liabilities and mortgage assests it wishes to retain as investments. Without an exception prohibition found in section 408(d) this would not be possible for the 120 or so savings institutions which are part of holding company families.

While section 114 would permit mortgage securities subsidiaries to operate on a more flexible basis, it would not enable them to escape regulatory constraints. Under section 5 of the Home

Owners' Loan Act and section 412 of the National Housing Act, the Federal Home Loan Bank Board would have full authority to issue comprehensive regulations concerning operations of mortgage securities corporations.

Personal property leasing power for national banks

The Garn-St Germain Act of 1982 provided that Federally chartered savings and loans may offer leasing of personal property as a financial service. Recent case law has limited the right of national banks to lease personal property to those situations where the bank links the lease to a loan on the personal property, i.e. where the personal property leasing is incidental to the business of banking, such as the lending of money. (See M&M Leasing Corp v. Seattle First National Bank, 563 F.2d 1977 (9th Cir. 1977), cert. denied, 436 U.S. 956 (1978) ands Interpretive Ruling 7.3400 (12 CFR Sec. 7.3400).

The Committee desires to extend explicit parallel powers for leasing to national banks in order to achieve competitive parity between national banks and federal thrifts.

Securities affiliates of banks and thrifts

Sections 112 and 106 apply the affiliation and management interlock prohibitions of sections 20 and 32 of the Glass-Steagall Act to securities firms and FSLIC-insured thrift institutions and to FDIC-insured nonmember state banks. Presently, these prohibitions apply to such relationships between securities firms and national banks and to state member banks.

During the past several years, some institutions not covered by sections 20 and 32 have become engaged in a broad range of securities activities through affiliates and subsidiaries. The Federal Deposit Insurance Corporation has issued a proposed regulation to limit such activities by state nonmember banks under its supervision but the proposal would permit securities activities beyond those authorized for member banks or contemplated for bank holding companies under this bill.

Since the enactment of the Glass-Steagall Act, Congress has been reluctant to expand the limited bank securities activities permitted under that Act. In view of this practice and in light of the fact that the bill contains specific securities activities deemed appropriate for banking organizations to engage in, the Committee deems it appropriate to apply the Glass-Steagall standards to all federally-insured depository institutions. This framework ensures competitive equity and the continued safety and soundness of the financial system.

Control affiliations and executive or employee interlocks commenced prior to July 1, 1983 would be grandfathered.

Senator Gorton offered an amendment during the mark-up which was agreed to without objection, to revise the grandfather language in order to clarify that the continuation of an ownership affiliation between a securities firm and an institution described above also permits the continuation of "officer, director or employee" relationships between such firms. This would permit the placement of personnel of affiliated companies as such persons retire or leave the employ of the relevant firms.

By applying the section 32 restrictions to all FDIC-insured non-member state banks, FDIC-insured branches of foreign banks would be covered. The Committee intends that such domestic branches be eligible under the grandfather provisions to the same extent as other FDIC-insured institutions.

TITLE II—AMENDMENTS TO THE FEDERAL CREDIT UNION ACT

The general purposes of this title are to make a small number of technical and clarifying amendments to the Federal Credit Union Act in order to provide the National Credit Union Administration with flexibility in its regulation of credit unions, to give credit unions new and additional latitude in the management of their internal affairs, and to clarify the precise meaning of some words and phrases in the Federal Credit Union Act about which some confusion had existed.

Some of the amendments are revisions and refinements made necessary by the many changes which were made by the Garn-St Germain Act. A change was made in the Garn-St Germain Act to eliminate the distinction between second mortgages made for home improvement, and all other second mortgages. In the process, unsecured home improvement loans were inadvertently eliminated from the section of the statute which delineates those types of loans which may be extended for a fifteen year term.

The bill restores explicit authority to federal credit unions to make home improvement loans and for terms up to 15 years. It also gives the NCUA Board discretion to permit terms longer than 15 years for home improvement loans and second mortgages in order to provide credit unions with flexibility comparable to other financial institutions in extending real estate related loans. The provisions would for example, permit a credit union making a variable rate loan to offer an extended period of repayment as an alternative to a balloon payment or higher monthly payments and would provide generally for greater real estate lending flexibility.

Also, the Garn-St Germain Act altered the requirements necessary for a credit union to convert from a federal charter to a state charter. It provided that such a conversion is approved if a majority of those voting on the proposal vote for the conversion. The bill provides the same standard to change a credit union's insurance status from federal insurance to state or private insurance. Failure to change the present requirement that at least twenty percent of all of the credit union's members participate in the election could require a credit union to hold two elections in order to change from federally chartered, federally insured status to state chartered state or privately insured status. Clearly, the decision to change charters is equal or greater in importance and the Committee intends that there not be a higher standard for the insurance conversion election.

Another provision which is related to the Garn-St Germain Act is the elimination of the provision in that act which sunsetted the conservatorship authority granted in that act to the NCUA Board. This conservatorship authority, which is similar to that of the FDIC and FHLBB, has proven to be an effective administrative tool for the NCUA Board in better ensuring the safety and soundness of

credit unions. It has remedial aspects not found in other forms of agency action. It permits the agency to freeze an institution in the position it finds it upon the imposition of conservatorship and thereby prevents a dissipation of assets that could have a substantial adverse effect on that credit union's members, creditors, and the National Credit Union Share Insurance Fund. It has particular value and importance where publicity about a credit union's soundness may trigger substantial share withdrawals and thus endanger the credit union's deposit base and the soundness of the institution in general

The conservatorship option is also a valuable tool in the case of Federally insured state chartered credit unions where the NCUA Board's ability to act is somewhat restricted, even though there is a consensus with the state authority that immediate action is necessary. Normally, the NCUA Board must wait for a state agency to place a credit union into liquidation and several months may elapse due to state procedural requirements. At that point, the NCUA Board accepts appointment as liquidating agent. During this period of time, it is the Share Insurance Fund which is at risk, not the state authority, buth the state authority is unable to expedite the matter. The NCUA Board would have no course of action to pursue to protect its interests because other forms of administrative actions do not provide for the controlling of credit union operations, as is the case in a conservatorship, and state procedural requirements on the state authority permits dissipation of assets.

Conservatorship has other benefits. In some cases obtaining control of a credit union's operations and assets has precluded its officials, suspected of self-dealing and other questionable activities, from tampering with or destroying records of their activities, thereby preserving evidence where criminal activity was suspected.

It is also beneficial where the true causes of a credit union's problems, and thus the appropriate remedy, are not easily ascertainable. If problems are not sufficient to warrant liquidation, it allows the NCUA Board the flexibility to work with credit union personnel to reopen the institution while at the same time preserving its integrity. This is accomplished by controlling the impact of outside influences which could otherwise seriously impair its viability. Liquidations may sometimes be inevitable but the value of the credit union may have been preserved, or losses reduced, for the benefit of all concerned, by the use of the conservatorship.

The bill also serves to eliminate confusion and provide flexibility for credit unions by clarifying the power of the NCUA to define the risk that credit unions must insure against through their fidelity bonds for officers and employees. The present statute requires "faithful performance" bonds for financial officers and fraud and dishonesty coverages for all officers and employees. Case law has held this to be a different standard from similar bond requirements for other financial institutions, holding that credit union bonds must cover acts of simple negligence, while bonds for other financial institutions are required only to insure against fraud and dishonesty by officers and employees. Such a high standard for credit unions could lead to such bonds becoming prohibitively expensive for credit unions, and the bill is intended to provide credit unions

with a standard for its fidelity bonds comparable to the standard for financial institutions.

The bill also provides other minor and technical revisions to current credit union statutes. (Note: the bill provides federal credit union boards with the power to set interest rate limits on the loans they offer. This, however, is done in Title VII of the bill, which deals with usury limitations.)

TITLE III—BANKERS' BANKS

This title was included to clarify the statutory provisions regarding bankers' banks. The statute authorizing export trading companies and the statute authorizing bankers' banks were both passed into law at approximately the same time, in October 1982, but authority for bankers' banks to invest in export trading companies was not included in the statute creating bankers' banks. In order to correct this oversight, the bill grants explicit authority for bankers' banks to invest in export trading companies. It also clarifies the Committee's intent that bankers' banks be able to offer service to other bank holding companies and their subsidiaries and affiliates, and makes other minor technical amendments.

TITLE IV—INTEREST ON RESERVES

The Depository Institutions Deregulation and Monetary Control Act of 1980 established the Depository Institution Deregulation Committee (DIDC) and charged it with phasing out Regulation Q interest rate ceilings on deposit accounts by March 31, 1986. The Monetary Control Act also extended the Federal Reserve's reserve requirements to all depository institutions.

In response to flows of funds out of depository institutions and into higher yielding money market mutual funds, the Garn-St Germain Depository Institutions Act of 1982 directed DIDC to create a new deposit account that would be competitive with the funds. DIDC authorized commercial banks, savings banks and savings and loan associations to begin offering the ceiling-free money market deposit account (MMDA) in December 1982 and the ceiling-free Super NOW account in January 1983.

The competitiveness of those new accounts has been hampered, however, because they are subject to non-interest bearing reserve requirements while the money market mutual funds are not. Title IV would effectuate the objective of the Garn-St Germain Act by providing for the payment of market interest rates on reserves held at the Federal Reserve against MMDAs, Super NOWs, and other similar ceiling-free accounts, including credit union share draft accounts. Interest would not be paid on reserves held against regular NOW accounts until the removal of interest rate ceilings on those accounts.

Interest would be paid monthly, the rate equalling that earned during the same month on the securities portfolio of the Federal Reserve System. The Congressional Budget Office estimates that, if interest were paid on the eligible reserves at this rate throughout 1984, the cost would be $200 million.

TITLE V—CONSUMER LEASE AND LEASE PURCHASE-AGREEMENT ACT

Title V of the bill creates a new Title X to the Consumer Credit Protection Act for the regulation of longer term leases, and short-term leases containing an option to purchase, or "lease-purchase agreements." The provisions of this Title are substantially similar to those submitted in draft legislation and recommended to the Congress by the Federal Reserve Board in 1983. In July of 1983, the Subcommittee on Consumer Affairs held a hearing on the Board's proposal and received testimony from Nancy Teeters, Member of the Board of Governors of the Federal Reserve System; representatives from the National Consumer Law Center and Legal Services of Greater Miami; representatives from the Association of Progressive Rental Organizations; the Furniture Rental Association of America, the American Rental Association; and representatives from the American Bankers Association and the Consumer Bankers Association.

This title simplifies the current Consumer Leasing Act, which covers leases longer than four months, for personal property used primarily for personal, family, or household purposes. The concepts and principles used in the 1980 simplification of the Truth-in-Lending Act were applied to simplify the leasing rules. Both the number and complexity of the disclosure requirements in current law have been reduced to emphasize information which is the most essential and helpful to consumers. Like credit disclosures under the Truth-in-Lending Act, leasing disclosures would have to be placed in a "federal box" and segregated from other contractual terms to highlight the disclosures for the consumer. This title also changes the statute of limitations, which is now one year from the end of the lease term for all violations, to one year from the consummation of the lease for disclosure violations, and one year from the end of the lease term for substantive end-of-the term liability violations. Current law requires the lessor to always pay consumers' attorneys' fees in all suits to collect more than the maximum allowed in an open-end lease. This title provides that the lessor must pay for consumers' attorneys' fees only when the lessor's action is unsuccessful. This title, for the first time, would subject lease extensions to limitations on the "balloon payment" consumers may be required to pay at the end of an open-end lease term.

Finally, the statute has been rewritten in short, concise sentences, or "plain English", to eliminate redundancy and unnecessary legalese. The Committee agrees with, and underscores, the Board's observation that the "plain English" effort presents some risk, of course, that editorial changes may be seen to imply a change in meaning where none was intended. However, the Board concluded "that the benefits from improved readability outweigh any potential misunderstanding."

This title also covers, for the first time, shorter-term leases which contain an option to purchases, or "lease-purchase agreements." A lease-purchase agreement is defined as an agreement for the use of personal property, for personal, family or household purposes, which is for less than four months duration, is automatically renewable with each payment, and permits the consumer to become the owner of the property. Covered transactions typically

include furniture, appliance and television rentals. The original language of the Federal Reserve Board proposal was amended to include any type of ownership feature associated with lease-purchase agreements, including completion of a specified number of scheduled payments, and/or payment of a percentage or specific amount to acquire ownership of the leased property.

The Federal Reserve Board proposed inclusion of lease-purchase agreements because of public concern over the number of consumers entering such agreements without adequate cost disclosures. Consumer representative testifying before the Consumer Affairs Subcommittee contended that lease-purchase advertising is often directed at low-income consumers and emphasizes "ownership" of appliances, without diclosing the amount required and other conditions to own. These representatives listed examples of consumers who were not told the total of payments needed to own in a lease purchase agreement, were not told they did not own the property under the agreement, and were not told whether the property was new or used. Consequently, the witness of the National Consumer Law Center testified that:

> The NCLC feels that many of the problems concerning appliance rentals could be alleviated by requiring that certain minimum disclosures be made by the appliance dealer. (Title V) provides a good starting point in addressing the problems associated with appliance rentals.

Similarly, a witness for Legal Services, Greater Miami area cited several examples of abusive practices involving lease-purchase agreements, and recommended that the Consumer Leasing Act "should be extended to cover renting agreements." Both witnesses, in fact, recommended that more extensive disclosure requirements be included.

To alleviate abusive practices in this area, this title requires five lease-purchase agreement disclosures: (1) the number, amounts, and timing of payments needed to acquire ownership; (2) the total of payments needed to acquire ownership; (3) a statement that the consumer will not own the property until all payments have been made; (4) a statement that the consumer is responsible for the fair market value of the property if it is lost or stolen, and (5) whether the property is new or used. It also regulates lease-purchase advertising, and subjects lease-purchase agreements to the civil liability, administrative enforcement, and other requirements of the Consumer Leasing Act.

The Committee rejected an amendment offered to this Title to strike coverage of lease-purchase agreements.

The author of the amendment argued that more disclosures—particularly of the fair market value and the annual percentage rate—were needed so that consumers could compare a lease-purchase arrangement to purchase of the item on a retail installment basis.

The Federal Reserve Board has defined a credit sale, for purposes of the Truth-in-Lending Act, to include leases where the consumer contracts to pay a sum substantially equivalent to, or in excess of, the total value of the property and services involved. The Board noted, in response to Committee questions its opinion that

lease-purchase agreements are not credit sales because each payment is for a short term rental period only and does not obligate the consumer to rent the property beyond the short-term rental. However, several states have characterized lease purchase agreements as credit sales, and this Title does not prohibit such State action. Commenting on the effect on the Act's narrow preemption standard in her testimony before the Committee, Governor Teeters stated that:

> States that wanted to treat (a lease-purchase agreement) as a credit purchase could have their own credit purchase disclosures, and as long as they are not in conflict with and are similar to Federal law, there is no reason why the State law can't stand side by side.

State regulation of these transactions as leases and lease-purchase agreements could provide for more disclosures and greater consumer protection than required by this Federal law.

TITLE VI—DELAYED AVAILABILITY

Title VI of the bill is the "Fair Deposit Availability Act of 1984." The provisions set forth in this title represent the culmination of several years of study, hearings before the Committee and concern over the practice of depository institutions in delaying the availability of deposited funds. The typical situation that brought this issue to the Committee's attention occurs when a person deposits a check in a bank, waits for a few days, and then writes several checks to pay bills—only to have the checks returned as unpayable because of "insufficient funds." The checks bounced because the check that was deposited to cover the amounts—sometimes a paycheck or a Social Security check—has not yet cleared. At this time, the person discovers that the deposited check has not cleared because the bank takes a week to release funds on an in-state check and two weeks to release funds on an out-of-state check. Because checks have "bounced", the person suffers the embarrassment of explaining the problem to the merchants and reissuing new checks after an appropriate amount of time. Finally, to make matters worse, the person receives notices from both the bank and the merchants that he or she will have to pay penalty charges because the checks bounced.

The Committee found this experience to be a common one. A 1979 American Bankers Association—Federal Reserve Board Task Force on Delayed Funds Availability concluded that "delayed funds availability is a widely employed and common banking practice." The Task Force found that the length of these "holds" varied, from an average of about 2-4 days on a check drawn on a bank in the same city to about 8-10 days on an out-of-state check. Not surprisingly, Federal Reserve Board surveys of "Reported Problems with Delayed Availability of Deposited Funds" in 1977, 1981 and 1983 revealed that 14%, 25% and 13% of people with checking accounts have experienced problems with delayed funds. Conservatively, that means that between 6.5 million and 12 million Americans have had problems with delayed funds at one time or another. But even these numbers understate the problem. A person who plans

his or her check cashing practices in light of the bank's hold policies will not experience a problem that will show up on the Fed's survey. However, that person may have other problems—from having to pay bills out of other, higher interest bearing accounts to paying late charges for interest because of an untimely payment.

The ABA-Federal Reserve Task Force pointed out that hold policies are necessary because it takes banks a considerable period of time to be sure that a check has cleared. Unfortunately, the present system of returning bad checks is cumbersome, time-consuming and labor-intensive. The Task Force also found that only 0.67% of all checks processed are returned and a 1973 study estimated bank losses from uncollectible checks at $5 million for the year. To balance these interests, the Task Force felt that banks could differentiate between established customers and new customers and "should retain the flexibility to provide established, financially responsible customers with funds availability on a schedule at least to the receipt of 'provisional credit' by the bank (the point at which a bank can use the funds) "without extending similar funds availability in situations that may involve crime or financially irresponsible individuals." For practicable purposes, this would mean access to one's funds within one to three days in almost all cases.

While the ABA-Federal Reserve Task Force recommendations were never implemented, several banks have adopted the approach of providing rapid availability for depositors with good records. At a hearing of the Consumer Affairs Subcommittee on March 10, 1982, a witness for the Bank of America testified that the bank "places holds on only a small portion of the checks deposited with us." The most common situations where the Bank of America places holds on deposits occur "where the depositor is a new customer without an established relationship with the bank, in nonrecurring events such as a large dollar deposit on the sale of a home, or where the account has developed a pattern of bad checks in the past." As a result of this policy, the Bank of America places holds on less than ½ of 1% of all checks.

In the 98th Congress, the Consumer Affairs Subcommittee addressed the subject of delayed funds within the context of S. 573, legislation introduced by Senator Dodd that would have required both disclosure of hold policies by banks and an expedited system for returning bad checks. In September, 1983, the Subcommittee held another hearing, at which the following witnesses testified: Preston Martin, Vice Chairman of the Federal Reserve Board; a representative of the Federal Home Loan Bank Board; representatives from Consumers Union and People, Inc.; representatives from the American Bankers Association and the Consumer Bankers Association; and Professor Steven Wechsler of the Syracuse University College of Law.

The Consumers witnesses cited the problems caused by the practice of delaying funds, from minor irritations to serious difficulties involving borrowing funds or making alternative financial arrangements. Representatives from the banking community cited their voluntary actions. Specifically, they cited a letter from the ABA to all its members on August 2, 1983, calling on them to develop bank policies on holds and disclose those policies to their customers.

Banking witnesses pointed out that the system for returning bad checks remains antiquated and expressed a concern over the potential for fraud, the cost of expediting the return system and the impact of federally mandated availability schedules, endorsement standards and notification requirements.

Among other things, the Federal Reserve Board testimony discussed its Dallas pilot project, designated "to determine the feasibility of establishing a nationwide service for the direct return of unpaid checks to the institution of first deposit. . .".

Professor Wechsler emphasized that "we are dealing with a very complicated technology here." He went on to call for legislation to expedite the return system leaving the details up to the Federal Reserve Board:

> I believe the statute should set the broad goals and should leave the fine tuning to the expert regulators who are the closest to the problem . . . the Board of Governors of the Federal Reserve System should be charged with issuing regulations. . . . All of the details, such as the appropriate amount, the methods of use, and also a phasing in schedule to allow banks to adjust their computer programs could be left to the Board.

The Committee bill generally adopts a modified version of the approach recommended by Professor Wechsler.

Title VI has three main parts: First, it requires depository institutions to disclose their policies relating to delaying availability of customers' deposited funds. Second, it instructs the Federal Reserve Board to issue regulations designed to expedite the availability of check deposits. Third, it requires the Secretary of the Treasury to issue regulations to provide next day availability for United States Treasury checks payable to and endorsed by a customer with an established relationship with the bank of deposit.

There are several disclosure requirements in this bill. First, the bill requires a depository institution to disclose its delayed availability policies to potential customers, in writing, before an account is opened. For purposes of this Act, a "potential customer" is a person who has expressed an interest in, or is in the process of, opening an account. Second, depository institutions must clearly and conspicuously post their general hold practices. Third, depository institutions must display a "brief reminder" that deposits may not be available for immediate withdrawal—such as a notice that "holds may be placed on some items"—at all automated teller machines (ATMs) and transmit the reminder in the mail to their customers at least annually. This requirement could be met by including the reminder in a regularly scheduled mailing or placing their reminder on a bank statement. Fourth, the bill requires depository institutions to disclose their hold policies over the phone at the request of any consumer.

The next major section of the Title addresses the issue of speeding up availability of check deposits. The Committee was confronted with very different views regarding the identity and nature of the "problem" causing delayed availability of funds. One school of thought argued that depository institutions could not safely provide consumers with the funds represented by their check deposits until

the entire time for a check to be returned through the system had expired. For a check drawn on an out-of-state bank, this time period easily could exceed 10 business days and most surveys place the present average hold times at 10 to 12 business days. Proponents of this viewpoint argued for the design of a speeded up return system. Such an approach (which could include automation of the return system) clearly would take some time to develop and implement.

On the other hand, other witnesses contended that most depository institutions could provide access almost immediately for most check deposits—as Bank of America and some other depository institutions now do—by looking at the specific characteristics of its accounts and account holders.

Given this division of opinion, the Committee chose to give the Federal Reserve Board 18 months to propose a regulation designed to meet the goal of providing one day availability for local checks and three day availability for all other checks. A final regulation to implement this goal must be effective no later than three years after the date of enactment of this legislation.

There are several important things to note about the "goal." First, it relates only to checks that do not represent a "serious risk of loss" to depository institutions. Second, it is a goal and not a requirement. It is the focal point for the Federal Reserve Board as it fashions regulatory requirements to provide customers with speedier access to their funds. In meeting this goal, for example, the Federal Reserve Board may well decide to have one set of rules incorporating the one and three day periods for checks that pose little or no risk to depository institutions, and another set of rules for checks that pose a greater risk, such as large denomination checks and checks drawn on new accounts.

Third, the Committee expects the Federal Reserve Board, by regulation, to identify guidelines to determine those checks that pose serious risks of loss to depository institutions. It has been suggested that the "serious risk of loss" factor can be evaluated by examining the nature of the deposit account and the accountholder. For example, has the check been deposited into an established deposit account where there has been sufficient activity to enable the depository institution to determine whether there is an increased risk of loss for return of unpaid deposited items? The length of time the account has been maintained, past experience with the depositor, and whether the depositor has other accounts with the institution may all be factors institutions should consider in formulating delayed availability policies and identifying those checks which may represent a serious risk of loss. Should the Federal Reserve Board decide that depository institutions can assess risks in this manner, then it may well need far less than three years to promulgate a final regulation.

On the other hand, if the Federal Reserve Board chooses to take the approach of speeding up the return process, it could well take the full three years to device the best combination of reforms to meet the goals of the bill in the most cost effective manner. To assist the Federal Reserve in its deliberations, the Committee has provided a nonexclusive list of 12 factors to consider as possible

subjects of regulatory activity. In addition, the Title calls for the establishment of an Expedited Funds Availability Council.

Finally, the Committee chose to require next day availability of deposits for United States Treasury checks. These checks are often deposited and needed by Social Security recipients and retirees. The historic reason for delaying availability on these checks has been the concern about fraud. To avoid that problem, the bill requires next day availability only on government checks drawn on the United States Treasury first endorsed for deposit by a customer with an established relationship with an institution.

The Committee firmly believes that implementation of Title VI will strike the proper balance between the need to protect banks from legitimate risks and the need to provide customers access to their funds expeditiously.

TITLE VII—THE CREDIT DEREGULATION AND AVAILABILITY ACT

Title VII of the bill renews the federal preemption of state usury laws for business and agricultural credit, last enacted in 1980 as part of the Depository Institutions Deregulation and Monetary Control Act of 1980. That preemption, which expired on April 1, 1983, proved to be instrumental in maintaining credit availability to the business and agricultural communities during the volatile and often high interest rate periods which characterized the financial environment in the early 1980's. The Federal alternative ceiling established by the 1980 legislation—5 percent in excess of the discount rate—served as a safety net to continue credit flows to small and large businesses and farmers, and avoid a serious reduction in credit availability during high interest rate periods. Although most states have raised their interest rate ceilings over the past several years, a number of states continue to have interest rate laws applying to certain categories of business and agricultural lending which could choke off credit should interest rates rise. Therefore, the Committee considers it necessary once again to provide a federal preemption of these laws.

The 1980 legislation provided states with a three year period within which to override federal law. State usury ceilings for business and agricultural loans in those states which acted during the three year period will not be affected by this preemption, unless the transitional rules set forth in the bill apply. Furthermore, states which have already taken action to override the 1980 federal preemption need not act again to override the preemption contained in this bill. States which have not addressed the federal preemption of state business and agricultural credit ceilings may override this preemption.

Committee adopted an amendment offered by Senator Dodd which (1) sets an alternative federal interest rate ceiling calculated as five percent above the United States Treasury's three year constant rate maturity series; (2) sunsets this federal preemption on July 1, 1987, and (3) requires the Federal Reserve Board to study the impact that this Title has on interest rates and the availability of business and agricultural credit. The findings of the Board must be reported to the Congress no later than december 31, 1986.

The particular Treasury series used in the index was chosen because the Federal Reserve believes that it represents a far more accurate market rate than the discount rate. Senator Dodd said such a rate is intended to be far enough above market rates to permit the competitive marketplace to operate, but low enough to prevent any possible gouging in areas that presently are not adequately competitive. As of June 22, 1984, the index would authorize lenders to charge 18.43%, which was about 5.5% above prevailing rates for business loans and about 4% above the rates for agriculture loans. The 18.43% was above the entire distribution curves of actual interest rates for farm loans in May of 1984, according to the *Federal Reserve Quarterly Survey of Bank Lending to Farmers*. The purpose of this study is to determine the real world effect of the preemption.

This Title also removes the cumbersome requirement that loan rate ceilings for Federal credit unions may be raised by the NCUA Board, only under certain economic circumstances, and only for periods not to exceed 18 months. Without such NCUA Board action, all loan rates revert to 15%.

TITLE VIII—BROKERED DEPOSITS

Title VIII corrects a defect that has come to the Committee's attention in the insurance scheme for deposits in institutions insured by FDIC and FSLIC. Some deposits in banks which failed during the period from January 1, 1982 through May 31, 1984 were placed in those institutions by brokers who received a fee for finding an institution which paid a high rate of interest on time deposits. Many institutions which were experiencing funding or financial difficulties during that period, and some institutions which failed, paid higher rates of interest than were available in more stable institutions, as a method for attracting depositors. FDIC, FHLBB, and the Board of Governors of the Federal Reserve believe that brokered deposits pose a threat to the deposit insurance funds. In a regulation promulgated at 49 Fed. Reg. 13003, FDIC and FHLBB tried to limit the exposure of the funds through brokered deposits by taking the position that insurance on deposits placed by or through a deposit broker would be limited to $100,000 per broker in each insured institution. This regulation was held invalid by a decision of the U.S. District Court for the District of Columbia, as unjustified by the applicable statutes.

The Committee shares the concern of the regulatory agencies to some extent, but thinks that the agencies goal can be accomplished with a less onerous provision. Therefore, the bill limits the aggregate amount of brokered funds held in any institution, but does not preclude appropriate gathering of brokered funds.

Title VIII limits the aggregate amount of brokered funds that may be held to the lesser of 200% of the insured institution's unimpaired capital and surplus or 15% of the insured institution's total deposits.

Title VIII also provides that unless permission is granted by FSLIC, a FSLIC insured institution which fails to satisfy the minimum net worth requirements established by the FHLBB shall not accept any additional insured accounts placed by or through a de-

posit broker. The minimum net worth regulations of the FHLBB, under which insured institutions are required annually to meet certain minimum net worth requirements calculated as a percentage of liabilities, are a principal measure by which the capital adequacy of thrift institutions is evaluated for general regulatory purposes. The bill provides that the minimum net worth requirements applicable to a given insured institution for general regulatory purposes shall also be the standard which, if not met, will trigger FSLIC screening of the acceptance of additional brokered deposits. Such approach assures that the use of brokered deposits will be evaluated in the context of financial standards generally applicable to the thrift industry and eliminates any need for an insured institution to make separate calculations as to its eligibility to accept brokered deposits.

Similarly, an institution insured by the FDIC failing to meet the minimum net worth requirements established by the FDIC or other appropriate federal banking agency shall not accept any additional insured accounts placed by or through a deposit broker.

TITLE IX—CREDIT CARD FRAUD

Credit card fraud has soared at an alarming rate. Estimates of loss to the industry as a whole—including financial institutions, oil, retail, travel and entertainment issuers—approached $1 billion in 1982, more than a 300 percent increase over 1979 figures. Ultimately these losses will be passed on to the consumer in the form of higher prices, higher interest rates, or higher card charges.

Legislation to strengthen and broaden existing statutes addressing fradulent use of credit cards, and debit cards, was introduced in the Senate as S. 1555 on June 28, 1983. The Subcommittee on Consumer Affairs held a hearing on May 18, 1983, receiving testimony from James Knapp, Depty Assistant Attorney General, Criminal Division, Department of Justice; Charles P. Nelson, Assistant Chief Postal Inspector for Criminal Investigation, U.S. Postal Service; John G. Alexander, chairman of the American Bankers Association Task Force on Credit Card Fraud; James R. Branam, Jr., on behalf of the Florida Bankers Association; William Neuman, vice-presient for security, VISA International; Thomas Kelleher, vice president for security, MasterCard International; Milton Schober, on behalf of the American Retail Federation; and, William B. Price, president, CBC Co., Inc., Columbus, Ohio.

S. 1555, with minor modifications, became Title IX of the larger legislative banking package, S.2181.

Title IX amends those provisions of the Truth-in-Lending Act and the Electronic Funds Transfer Act which address the Fraudulent use of credit and debit cards. The amendments are designed to strengthen, modernize, and broaden existing statutes so that they apply to today's fraudulent credit card activities. For example, the definition of a "credit card" in present law has been interpreted to exclude account numbers, although fraudulent use of account numbers is more common and prevalent than fraudulent use of the card itself. Consequently, Title IX expands the definition of "credit card" and "debit card" to include account numbers or other access means. Current law has been interpreted to require purchase of $1000 of goods on a single card. Title IX amends the statute to cover $1000 of pruchases made on one or more cards. Title IX also makes it unlawful to posses five or more counterfeit, fictitious, al-

tered, forged, lost, stolen, or fraudulently obtained credit or debit cards; to furnish, transfer or obtain a credit or debit card for use in connection with schemes to defraud; and fraudulently to use a credit or debit card account number. Finally, this Title increases criminal penalties for subsequent violations to a fine of not more than $100,000 or imprisonment for not more than 20 years, or both.

TITLE X—INTERSTATE BANKING

Title X amends the National Bank Act, the Bank Holding Company Act of 1956, the Federal Deposit Insurance Act, and the National Housing Act, all to accomplish one principal legislative purpose, the elimination of possible impediments to states' enactments of laws determining the nature and scope of interstate banking within their boundaries.

In modifying the National Bank Act, 12 U.S.C. 36 the Act of February 25, 1927, (referred to in this report as the "McFadden Act"), provided authority for the establishment of branches by national banks. In order to maintain competition within the nation's dual banking system, the McFadden Act permitted national banks to establish branches within their own home cities, towns, or villages if the establishment and operation were expressly authorized by the law of the appropriate state for state banks. Under a 1933 amendment to the McFadden Act (48 Stat. 189, 12 U.S.C. 36), national banks further were permitted to establish branches throughout their home states if the state law in question authorized branching within the state "by language specifically granting such authority affirmatively and not merely by implication or recognition".

Section 3(d) of the Bank Holding Company Act of 1956 (the "Douglas Amendment") paralleled the restrictions contained in the McFadden Act, by prohibiting a bank holding company or a subsidiary of a bank holding company from acquiring, directly or indirectly, any voting shares of, interest in, or all or substantially all of the assets of a bank located outside the state in which the bank holding company principally conducts its business, except that a bank holding company is permited by present law to acquire the shares or assets of a state bank, if such acquisition specifically is authorized by the laws of the state in which the acquired bank is located, by language to that effect and not merely by implication.

Other federal statutes also affect interstate expansion by financial institutions. Section 18(c) of the Federal Deposit Insurance Act sets forth certain procedures regarding the approval of mergers and acquisitions involving FDIC-insured institutions. Similarly, the National Housing Act and the Home Owners Loan Act of 1933 give the Federal Home Loan Bank Board ("FHLBB") and FSLIC approval powers over mergers and acquisitions involving FSLIC-insured institutions. Finally, section 408(e)(3) of the National Housing Act denies the Federal Home Loan Bank Board the power to approve an acquisition, if such acquisition would result in a savings and loan holding company owning or controlling thrift institutions in more than one state.

Title X of the bill amends each of these statutes to facilitate interstate expansion by depository organizations, subject to any restrictions in their home state's statutes, or in the other state's or

states' statutes. The procedural requirements under 12 U.S.C. 214a and 215a governing intrastate mergers and acquisitions of federally-insured institutions are also intended to apply to mergers and acquisitions authorized by Title X. With respect to each statute amended, the bill specifically provides that states may allow such expansion without restriction, or on the basis of the location of the states involved, the existence of statutes in the other state or states providing for reciprocal treatment of its own state banks, or other, similar conditions. Title X would apply to mergers and acquisitions currently pending before the regulatory agencies, as well as to future mergers and acquisitions. Several institutions have made arrangements which are contingent on further changes in the law affecting the expansion of interstate banking, and it is not intended that the bill will have any effect on such arrangements.

Title X also would express Congressional endorsement of and consent to enactment by one or more of the states of restrictions on branching or acquisitions within its borders by out-of-state institutions, or out-of-state by its own banks and bank holding companies. These state-imposed restrictions may be based upon the state location of institutions desiring to come within its borders, the existence of statutes in other states providing for reciprocal treatment of its own banks, or other similar restrictions designed by the state legislatures.

Rationale

Evidence heard by the full Committee indicated that the restrictions on interstate banking in the McFadden Act and the Douglas Amendment are not effective. While banks and bank holding companies have devised various mechanisms for operations interstate, often with the approval and sanction of federal regulatory agencies, other financial service providers are not constrained by any geographical limitation, and can offer competitive services directly, without the expense and delay imposed on banks and bank holding companies by the need for regulatory approval. Banks and bank holding companies also offer some interstate services (such as domestic and international commercial lending services, consumer loans, and lease financing) through loan production offices, Edge Act corporations, industrial banks, retail credit card operations, and shared electronic fund transfer terminals, among others. Many of these services were not contemplated at the time of the McFadden Act. Thus, the McFadden Act and the Douglas Amendment do not preclude banks and bank holding companies from providing interstate banking services, but limit only the direct provision of such services. The legal and accounting requirements necessary to engage in such activities may be prohibitively expensive for smaller institutions.

The Committee acknowledges the long and successful history of the nation's dual banking system, however, and recognizes that each of the states have unique demographic circumstances from which unique instrastate methods of delivering banking services have evolved. Each state government is well positioned to understand the effects that further interstate banking would have on its consumers of banking services, as well as its financial institutions. As discussed below in the section-by-section analysis of this legisla-

tion, Title X respects the rights of each state of self-determination in banking, consistent with the historic preservation of equality between nationally chartered institutions and state chartered institutions.

Constitutional issues

Several states have adopted reciprocal legislation extending banking privileges to out of state banks and bank holding companies from states which adopt similar statutes. As of June 30, 1984, Florida, Georgia, South Carolina, Kentucky, Connecticut, Massachusetts, Rhode Island, New York and Utah had passed such statutes (although not all of the state statutes are effective yet). The bill acknowledges the geographic and variety of other limitations contained in some of these statutes.

The constitutional authority for the Connecticut and Masschusetts statutes, referred to above, has been questioned in litigation now pending in the Second Circuit Court of Appeals, *Citicorp* v. *Board of Governors of the Federal Reserve System*, and in the U.S. District Court for the District of Massachusetts, *Citicorp (and affiliates)* v. *Massachusetts Board of Bank Incorporation et al.*

Under Article I, Section 8, clause 3 of the Constitution, Congress has the power, among others, to "regulate commerce with foreign Nations, and among the several States . . .". It is clear that the commerce clause gives Congress the authority to regulate even intrastate affairs, to the extent that they affect interstate commerce. *NLRB* v. *Northern Trust Co.*, 56 F. Supp. 335, aff'd 148 F. 2d (D.C. Ill. 1944). It has been argued that state statutes such as those already enacted might be found by the courts to create an undue burden on interstate commerce.

Although each of the states referred to above has enacted its own separate statute, it has been argued that the reciprocal nature of some states' legislation results in the creation of interstate banking "compacts". In *United States Steel Corp.* v. *Multistate Tax Commission*, 434 U.S. 452 (1978), the Surpreme Court indicated that the focus of the compact clause (Article I, Section 10, clause 3) is sufficiently broad to encompass reciprocal statutes which "present opportunities for enhancement of state power at the expense of the federal supremacy similar to the threats in a more formalized compact . . ." and that "the (Compact) clause reaches both 'agreement' and 'compacts', the formal as well as the informal". 434 U.S. 453, 470–471.

The history of the dual banking system, where Federal laws and state laws are mutually applicable to institutions, suggests that the passage of state statutes contemplating reciprocal interstate banking compacts might create opportunities for enhancement of state power at the expense of federal supremacy. Although the McFadden Act and the Douglas Amnendment adopted state branch banking standards as the Federal standard, the very existence of these statutes might be viewed as evidence of Federal supremacy in regulating the affairs of national banks. Thus, when enacted, Title X will signify Congressional consent to reciprocal interstate banking statutes by the states on such terms as each of the states deems appropriate, to the extent permitted by Title X. It also constitutes a Congressional expression of its political judgment that such state

statutes are not likely to interfere with Federal activity in the area, and are not likely to disadvantage other states to an important extent.

As indicated above, some states have already adopted legislation along the lines addressed in Title X, while others have not, and may not, adopt legislation. The adoption of Title X removes constitutional impediments under the commerce and compact clauses for state statutes already enacted and to be enacted in the future of the kind described in sections 1002 and 1003 of the bill. *Cuyler* v. *Adams*, 449 U.S. 433, 441 (1981).

State statutes granting privileges to citizens or residents of another state only if the other state grants reciprocal treatment also have been tested under the equal protection clause of the Fourteenth Amendment to the Constitution. If such state statutes are rationally related to a legitimate state policy or interest, they have been held inviolate on equal protection grounds, even if they result in discrimination against a certain group. *Hawkins* v. *Moss*, 503 F. 2d 1171 (4th Cir. 1974), *New Orleans* v. *Dukes*, 427 U.S. 297 (1976). With respect to economic legislation, the test of whether a state statute is rationally related to a legitimate state policy has two elements: (1) whether the statute has a legitimate purpose, and (2) whether the state legislature reasonably could have believed the discriminatory classification would promote the state purpose. *Minnesota* v. *Clover Leaf Dairy*, 449 U.S. 456 (1981). In testimony before the Committee, several State banking commissioners recognized that interstate banking would continue to evolve, but thought that local banking institutions would need to balance the unique needs of their own states and regions with the need for growth in order to be able to compete with money center banks. A court may find that these are valid state interests.

The Committee recognizes that the legal arguments outlined above are not frivolous, but believes that the state statutes concerning interstate banking are consistent with both the constitution and the federal banking statutes amended by S.2181. These amendments make this position express and are warranted because state authority to enact such statutes should not be questioned on the grounds discussed herein and institutions affected should be able to expand under the provisions of such state laws without the burdens of litigation raising federal constitutional and statutory issues of the sort discussed above.

Title X is permissive with respect to state statutes, and maintains the status quo by allowing state statutes already enacted to stand. It also continues the tradition of allowing states to self-regulate branch banking. The details of this legislation are discussed in the section-by-section analysis portion of this report.

TITLE XI—MISCELLANEOUS

NOW accounts for political organizations

The bill provides that political organizations that are not operated for profit may own negotiable order of withdrawal ("NOW") accounts. This provides such organizations with the financial flexibility they need in conducting their affairs, by permitting access to NOW accounts at the various depository institutions throughout

the nation that offer such accounts. Such political organizations are of a nature that is consistent with that of institutions currently granted access to NOW accounts.

The Depository Institutions Deregulation and Monetary Control Act of 1980 provided that NOW accounts could be offered by depository institutions throughout the entire nation. Before that act was pased, NOW accounts were available in a limited number of states in the northeastern United states. The 1980 Act established the standard for organizations eligible for NOW accounts as non profit "organizations operated primarily for religious, philanthropic, charitable, educational or other similar purpose." The Committee desires to explicitly include political organizations in the list of organizations eligible for NOW accounts.

Payment system amendment

The Depository Institutions Deregulation and Monetary Contol Act of 1980 mandated the explicit pricing of check clearing and other payment services that the Federal Reserve Banks previously had provided without charge to members of the Federal Reserve System as one of the benefits of membership. The 1980 Act also gave non-member depository institutions access to the Federal Reserve's payment services.

Opening access to Federal Reserve payment services to nonmember depository institutions increased the extent to which the Reserve Banks compete with private sector firms in the provision of the same or similar payments services. In order to give private sector firms and equality of competitive opportunity, the 1980 Act required the Federal Reserve to charge prices for its payment services that would cover all of its expenses in producing those services.

Concern has since been raised that the requirement for full cost pricing is not sufficient to assure an equality of competitive opportunity for private sector firms. In particular, concern has been expressed that, given the dominance of the Federal Reserve in the payment services business, private sector firms cannot assume the risk of making new capital investments without prior knowledge of the Federal Reserve's planned near-term competitive strategies.

Concern also has been expressed that the Board of Governors' policy making responsibilities for the Federal Reserve's regulatory functions can give Reserve Banks a competitive advantage over private sector firms in the provision of payment services.

Private sector competitors and users of payment services as well have urged the creation of a formal group to advise the Federal Reserve of the impact on them of its payment services activities. Moreover, given the Federal Reserve's nationwide branch system, private sector competitors have argued that they need more freedom from geographic restraints.

To further assure an equality of competitive opportunity for private sector competitors of the Federal Reserve, Section 1104 would require the Federal Reserve to publish each year its plans for price changes, new services, capital investments, etc. The Federal Reserve Board's regulatory responsibilities would be required to be clearly separated from the operational responsibilities of the Reserve Banks.

Section 1104 also would establish a Payment System Advisory Council and remove geographic restraints on depository institutions in their competition with the Federal Reserve to clear evidences of transaction accounts for other depository institutions.

Corporate purchases of securities and executive compensation arrangements

Senator Riegle offered an amendment during the Committee's mark-up, which was agreed to without objection, to prohibit a company from purchasing its securities at a premium from any person or persons acting in concert who holds or hold more then 3 percent of the company's stock and who have held such stock for less than two years, unless the other shareholders of the company approve. This language is intended to prevent the payment of "greenmail", which is a play on the word "blackmail", and refers to the premium price which management is willing to pay such a purchaser of stock under these circumstances, to prevent a hostile takeover. Generally, this premium price exceeds the fair market value of the stock, as evidenced by the price at which it would be trading, absent the possibility of a takeover. Except for those shareholders who take advantage of the increased market activity incident to a possible takeover to sell their stock for an increased price, most shareholders do not realize any appreciation in their stock when a takeover is in progess; indeed, after the risk of a takeover has been eliminated, the value of the stock of the innocent shareholders may decline if the corporation used too much of its capital to buy back the shares of the persons attempting a takeover.

The practice of paying greenmail is one that the Committee thinks should be prohibited for several reasons. First, it favors one shareholder or group of shareholders over other shareholders. Second, it results in the use of corporate assets for purposes improper for a corporation, by way of these unfair redemptions. Third, management is placed in a conflict of interest in a takeover, and may be tempted to use corporate assets to protect its own position. For these reasons, the Committee thinks that a legislative prohibition will be the most effective method for eliminating the use of threats of takeover to obtain "greenmail".

Numerous bills already have been introduced on this subject, all of which are virtually identical to this one, which was recommended by the Securities and Exchange Commission subsequent to the issuance of a report on tender offers from the Tender Offer Advisory Committee, a distinguished panel of securities, corporate and labor leaders formed by the SEC to study issues raised by current tender offer and takeover activities.

S. 2754 was cosponsored by Senators Riegle, Proxmire and Sarbanes, and was introduced on June 13, 1984. Senator Chafee introduced S. 2779, a virtually identical bill, on June 20, 1984. Senator D'Amato included a greenmail provision in his bill, S. 2782, which was also introduced on June 20, 1984. On June 19, 1984, Senator Heinz introduced S. 2777, a virtually identical bill, which also contained a greenmail provision.

The provision permitting the payment of a premium to repurchase shares with the consent of the other shareholders insures that corporations will still be able to repurchase large blocks of

stock from shareholders who have made an investment commitment to the corporation; this permission also will eliminate partially management conflicts of interest in takeover situations.

Senator D'Amato offered a perfecting amendment, also agreed to without objection, to the Riegle amendment to prohibit companies from agreeing to provide lucrative compensation packages to officers or directors who might otherwise be adversely affected by prospective tender offers or other corporate takeover arrangements. This prevents "golden parachutes".

This provision would prohibit an issuer, during certain tender offers, from entering into or amending agreements that include "provisions, whether or not dependent on the occurrence of any event or contingency, that increase, directly or indirectly, the current or future compensation of any officer or director".

The chief advantage of this provision is the certainty that would result from a prohibition on any type of agreement that directly or indirectly increases the compensation of officers or directors. Although the prohibition is broad, it would not prevent hiring new officers or directors, nor would it prohibit compensation increases, even during the described category of tender offers, if such increases resulted from provisions of an agreement pre-dating the tender offer.

Similar to the "greenmail" provision, this amendment was included in a package of legislative recommendations submitted by the Securities and Exchange Commission to the Securities Subcommittee in May. The SEC shares the Tender Offer Advisory Committee's concerns with the adoption of such agreements. The Advisory Committee noted that, when such forms of compensation are adopted during a tender offer, they can present the appearance of self-dealing on the part of management at a time of corporate vulnerability, as well as a failure by management to place first and foremost the interests of shareholders. The SEC concurred in the Advisory Committee's judgment that such activities may so undermine the public's confidence in the integrity of the takeover process as to require a federal response.

The "greenmail" and "golden parachute" amendment was further revised by an amendment offered by Senator Heinz to establish the effective date of these stock purchase and compensation limitations as June 27, 1984, the date of the mark-up. The Heinz amendment was agreed to without objection.

Consumer banking statutes

Title XI makes several amendments to consumer banking statutes. In the 1980 Depository Institutions Deregulation and Monetary Control Act, the Congress exempted advances on open-end credit plans from the rescission rights set forth in the Truth-in-Lending Act. That exemption expires in October 1985. No problems have been reported with advances involving these transactions, so the Committee repealed the sunset, making the exemption permanent.

The Depository Institutions Deregulation and Monetary Control Act of 1980 has also been amended to require the Federal Home Loan Bank Board to publish model forms for mobile home loan transactions which qualify for federal usury preemptions. The pur-

pose of this amendment is to add certainty to the groundrules applying to these transactions so that creditors who have acted in good faith in using the model forms will be protected from liability for violations of this law.

Finally, the Committee removed the exemption for attorneys from coverage under the Fair Debt Collection Practices Act. Attorneys are becoming increasingly active in debt collections, and the vast majority are already in compliance with this Act.

This amendment reflects the intent of the Committee to impose the standards enunciated in the Fair Debt Collection Practices Act upon all those engaged in debt collection practices, whether or not they hold law degrees.

FINANCIAL SERVICES COMPETITIVE EQUITY ACT—TITLE-BY-TITLE ANALYSIS

TITLE I—FINANCIAL INSTITUTIONS COMPETITIVE EQUITY

Section 101—Bank Affiliation with a Securities Affiliate

Subsection 101(a).—Subsection 101(a) amends Section 20 of the Banking Act of 1933 (12 U.S.C. 377) to allow a member bank to be affiliated with a depository institution securities affiliate (defined in Subsectioin 104(a) of the bill). Although this provision permits such affiliation, it does not permit the member bank to own shares of such an affiliate, or otherwise to engage in securities activities. Thus, the activities authorized for a depository institution securities affiliate must be conducted either by the bank's parent holding company or by a separate subsidiary of the holding company.

Subsection 101(b).—Subsection 101(b) amends Section 32 of the Banking Act of 1933 (12 U.S.C. 78) to allow an officer, director, or employee of a member bank to serve at the same time as an officer, director, or employee of its depository institution securities affiliate or affiliates. Existing restrictions continue to apply to prevent such an interlocking relationship with a nonaffiliated depository institution securities affiliate or any other firm engaged in securities activities.

Section 102—Securities Act Exemption for Internal Reorganizations

Section 102 amends the Securities Act of 1933 to exempt from the registration requirements of that Act the issuance of a holding company's shares in connection with a sample reorganization in which a holding company becomes the parent of a bank or thrift institution.

Section 103—Supervisory Authority Over Bank Municipal Securities Activities

Subsection 103(a).—Subsection 103(a) amends the definition of "appropriate regulatory agency" in the Securities Exchange Act of 1934 so that the Securities and Exchange Commission is the appropriate regulatory agency for enforcing a depository institution securities affiliate's compliance with the statutory and regulatory requirements governing transactions in municipal securities.

Subsection 103(b).—Subsection 103(b) amends Section 15B of the Securities Exchange Act, which establishes the composition of the Municipal Securities Rulemaking Board to provide depository institution securities affiliates with representation on the MSRB equivalent to that of other municipal securities dealers and bankers engaged in the municipal securities business.

Section 104—Definitions and Powers of Bank Holding Companies

Subsection 104(a)—"Bank" and Other Definitions.—Subsection 104(a) amends the definitions used in the BHC Act by modifying the meaning of "bank" and by adding the terms "depository institution securities affiliate", "commercial loans", "depository institution holding company", "depository institution", "savings and loan holding company", and "insured institution".

a. "Bank" is defined to mean: (1) an insured bank as that term is defined in the Federal Deposit Insurance Act (12 U.S.C. 1813(h)); (2) any institution, whether organized under the laws of the United States, any state or the District of Columbia or any United States territory, that both accepts deposits that are withdrawable by a check or similar means and engages in the business of making commercial loans; or (3) a state-chartered, FDIC-insured, stock savings bank which was in existence on October 15, 1982, which is engaged in the business of making commercial loans, and which, on the date of enactment of the FSCEA, is not a Federal savings bank

The term bank does not include a foreign bank having an insured branch, a trust company, or an insured thrift institution (as defined in 12 U.S.C. 1730(a)(a)(1)). Furthermore, this bill continues to exempt Edge Act banks and organizations whose only United States business is an incident to their activities outside the United States.

This expanded definition of bank brings federally-insured nonbank banks under the jurisdiction of the Bank Holding Company Act.

b. "Commercial loans" is defined not to include personal loans, real estate loans, credit card loans, and investments in commercial paper, certificates of deposit, retail installment loans, accounts receivables, mortgage-backed or government securities and similar money market instruments. An institution is not deemed to be engaged in the business of making commercial loans if it has no more than 10 percent of its assets in commercial loans. This provision, to be used for purposes of defining a bank, would be applied to state chartered, non-federally insured institutions and to state chartered savings banks which are in stock form, were in existence on October 15, 1982, are FDIC-insured and are not federally chartered on date of enactment.

c. "Depository institution securities affiliate" means any corporation that (1) engages in the United States in one or more the activities authorized under subsection 104(3) of the bill, and (2) is either a broker or dealer within the meaning of the Securities Exchange Act or an investment adviser within the meaning of the Investment Advisers Act of 1940.

d. For purposes of the BHC Act, Subsection 104(a) of the bill defines the term "depository institution holding company" to mean

bank holding company and the term "depository institution" to mean bank. Similarly, for the purposes of the Savings and Loan Holding Company Acts, Subsection 107(a) of this bill defines the term "depository institution holding company" to mean savings and loan holding company, and the term "depository institution" to mean insured institution. As a result, a depository institution securities affiliate could be affiliated with either a bank or an insured thrift institution; a depository institution holding company could be either a bank or a savings and loan holding company.

Finally, Subsection 104(a) defines "savings and loan holding company" and "insured institution" for purposes of the Bank Holding Company Act as they are defined in the Savings and Loan Holding Company Amendments of 1967, as amended.

Subsection 104(b)(1)—Simplified Holding Company Formations.—Subsection 104(b)(1) amends Subsection 3(a) of the Bank Holding Company Act to provide a simplified, 30 day notice process for the formation of a bank holding company in which a person or group of persons owning bank shares transfers such shares to a newly formed holding company and receives substantially the same proportional share interests in the holding company that were held in the bank prior to the holding company's formation, provided that no other organizational change is implemented as part of such holding company formation.

Subsection 104(b)(2)—Grandfather Rights Under the Douglas Amendment.—Section 3 is further amended by adding language to Subsection (d) to prohibit any company from retaining nonbank banks which were acquired after July 1, 1983, which would have been prohibited under the Douglas Amendment if the new definition of bank had been in effect at the time of the acquisition or establishment of the nonbank banks. Divestiture under this provision would be required within six months of the date of enactment.

Subsection 104(c)—Direct Holding Company Activities and Grandfather Rights.—a. Activities: Subsection 104(c) amends paragraph 4(a)(2) of the Bank Holding Company Act to expand the types of activities in which a bank holding company may engage directly. Although the Bank Holding Company Act generally prohibits a bank holding company from engaging in nonbanking activities directly, paragraph 4(a)(2) of that Act authorizes a holding company to engage directly in those activities permitted under paragraph 4(c)(8) of the Act. Since Subsection 104(d) of the bill expands paragraph 4(c)(8) activities, all of these newly permitted activities may be conducted in the holding company directly. In addition, section 104(c) amends section 4(a)(2) to make the activities of a depostitory institution securities affiliate permissable for a bank holding company.

b. Grandfather rights: Subsection 104(c) also sets forth certain grandfather rights for companies that acquired so-called "nonbank banks" prior to July 1, 1983. No grandfather rights are provided for any company that acquires a nonbank bank after July 1, 1983. A company that owned a nonbank bank on or prior to July 1, 1983 may continue to operate its nonbank bank and not be a bank holding company, provided that (i) the company does not acquire an additional bank or insured institution (a thrift), (ii) the nonbank bank

does not both accept demand deposits and "engage in the business of making commercial loans" (as that term is defined in Subsection 104(a), and (iii) such a company engages in any activity of a financial nature not authorized for bank holding companies under section 4 of the Bank Holding Company Act in which it was not engaged on June 27, 1984. Comparable grandfather authority is provided to a company which was already a bank holding company on July 1, 1983 (by virtue of its ownership of a bank) and which also acquired a nonbank bank prior to that date. This would permit such a holding company to retain its bank subsidiary under existing statutory exemptions and to retain its nonbank bank subsidiary in accordance with this new exemptive provision. The Federal Reserve Board may terminate grandfathered status provided under this section.

Subsection 104(d)—Section 4(c)(8) Activities.—Subsection 104(d) amends Subsection 4(c) of the Bank Holding Company Act by deleting the current paragraph (8), which permits bank holding companies, after notice and opportunity for hearing and subject to prior approval by the Federal Reserve Board, to engage in activities closely related to banking.

a. "Closely related". Subsection 104(d) replaces that paragraph (8) with a new paragraph (8), which permits bank holding companies, after notice and subject to disapproval by the Federal Reserve Board, to engage in the following: (1) ownership of thrift institutions subject to bank interstate operations and branching restrictions; and (2) activities closely related to banking or managing or controlling banks. In determining what activities are "closely related", the Federal Reserve is required to take into consideration technological or other innovations in the provision of banking or bank-related services.

b. Procedures: Generally, a bank holding company must submit a notice to the Federal Reserve Board 60 days in advance of engaging in any of these activities. However, no notice is required where a bank holding company opens offices *de novo* or changes the location of existing offices with no change of activities. The Federal Reserve Board will, by regulation, prescribe the information that must be submitted, including information concerning the managerial and financial resources of the bank holding company.

c. Elements of Federal Reserve Board review: The assessment of public benefits as well as Federal Reserve Board consideration of possible adverse effects of any application—conflicts of interest, unsound banking practices, and competitive factors—are retained. In addition, the Bank Holding Company Act now requires that an assessment of financial and managerial resources be made. If additional information, not described by regulation, is required for any particular notice, the Federal Reserve Board may suspend the notice process, but then must act to disapprove the proposal within 30 days after the additional information is submitted.

d. Rulemaking: Within 180 days after the effective date of this Act, the Federal Reserve Board must promulgate regulations listing and describing specific activities that are closely related to banking and permitting bank holding companies, after notice and subject to the conditions of this section, to engage in those activi-

ties. The bill specifies that activities permitted as of the date of enactment of the bill are to be included in such a list.

e. Orders and Judicial review: The Board is directed to issue orders setting forth the reasons for any disapproval or determination not to disapprove, under this subsection. Under Section 104(h), such orders are subject to judicial review solely on questions related to the Board's finding that the activity is permissible and to Federal Reserve Board findings regarding the issue of unfair competition.

f. Limits on securities activities: The Federal Reserve Board, however, is prohibited from authorizing activities pursuant to this subsection that are of the kind described in paragraph 15 of Subsection 4(c) of the Bank Holding Company Act, or that are prohibited under Sections 16 and 20 of the Banking Act of 1933 (12 U.S.C. 24 (Seventh) and 377) as amended by this bill. The prohibition against authorizing the activities specified in paragraph 15 is to ensure that any securities activities conducted by a bank holding company are conducted only subject to the conditions and requirements of paragraph 15 of Subsection 4(c) of the BHC Act.

g. Acquisition of thrifts: Bank holding companies are authorized to acquire one or more thrift institutions. (The bill does not authorize a bank holding company to engage directly in the activities of a thrift institution). Any acquisition under this new authority is also subject to all of the limitations, conditions and requirements of the Savings and Loan Holding Company Act, to the Douglas Amendment of the BHC Act and to the McFadden Act as if the thrift were a bank and to the competitive tests under section 3(c) of the BHC Act applicable to bank holding company acquisitions of banks. Both the FSLIC and the Federal Reserve Board have authority to disapprove any such acquisition; but it is expected that the Federal Reserve Board will defer to the FSLIC as the primary regulator of the insured thrift in the area of the financial safety and soundness of such subsidiary.

Subsection 104(e)—Securities Activities.—Subsection 104(e) adds a new exemption to Subsection 4(c) of the Bank Holding Company Act to permit bank holding companies to operate a depository institution securities affiliate. As explained in Section 104(c) herein, such depository institution securities affiliate activities may be conducted by the bank holding company directly as well as through its nonbank subsidiary.

a. Transfer of bank securities activities: Subparagraph (i) of Subsection 104(e) prohibits any bank holding company that establishes or acquires a securities affiliate pursuant to this Section, or that engages in securities affiliate activities pursuant to Section 104(c) and this Section, from permitting any of its subsidiary banks to engage, directly or through a subsidiary, in any securities activity one year after the date the securities affiliate first engages in any of the specified securities activities described in subparagraph (iii). The activities that are not permissible for a bank subsidiary, and which therefore may be conducted only by the securities affiliate, include the activities specified in subparagraph (iii) described below and the following activities which are authorized under 12 U.S.C. 24 (Seventh) for banks: securities discount brokerage activities and dealing in and underwriting (1) obligations of the United States, (2)

general obligations of any state or local government, and (3) other obligations listed in paragraph Seventh of 12 U.S.C. 24.

The Federal Reserve Board is authorized by subparagraph (i) of Section 104(e) to prescribe rules and regulations identifying any securities and securities-related activities in which a subsidiary bank of a holding company may not engage one year after the date its securities affiliate first begins engaging in any activities described in subparagraph (iii). However, this authority does not extend to, and the bill is not intended to affect, the normal funding and investment practices of depository institutions.

Subparagraph (i) further states that in the event a bank holding company terminates the subparagraph (iii) activities of its depository institution securities affiliate, its bank subsidiary or subsidiaries may conduct (through the bank itself or through a subsidiary) any acitivities that a bank is authorized by law to conduct.

b. National bank's securities activities: Under subparagraph (ii) of Subsection 104(e), a depository institution securities affiliate is authorized to conduct all of the securities and securities-related activities that a national bank is not prohibited from conducting under Federal law.

c. Securities affiliate's activities: Subparagaph (ii) of Subsection 104(e) specifies activities that may be conducted by a bank holding company or a holding company securities affiliate, but that may not be conducted by a bank one year after the date its securities affiliate first begins engaging in any activities described in such subparagraph (iii). The activities specified in subparagaph (iii) include: dealing in and underwriting obligations issued or guaranteed by state or local governments, except most industrial development bonds; [1] and advising and open-end investment company; [2] underwriting and selling securities of any investment company; underwriting and selling mortgage-backed securities, and underwriting and selling commercial paper.

d. Transactions among affiliates: All transactions between a bank and its depository institution securities affiliate are subject to the restrictions on interaffiliate transactions contained in Section 23A and 23B of the Federal Reserve Act. This is discussed further under Section 105 herein.

e. Thrift securities affiliates: Subsection 107(b) of this bill provides that savings and loan holding companies also may acquire depository institution securities affiliates and may, either at the holding company level or through such affiliate, conduct all of the activities of a depository institution securities affiliate. In interpret-

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[1] While there is a general prohibition against dealing in and underwriting industrial development bonds, there are two situations in which depository institution securities affiliates may deal in and underwrite tax-exempt industrial development bonds: (1) if either a state or local government pledges its full faith and credit to guarantee payment of all principal and interest on such bonds; or (2) if the issuer (or the governmental unit on whose behalf the banks are issued), and only the issuer, is considered to be the sole owner of the financed facility for Federal income tax purposes.

[2] Pursuant to subparagraph (iii), a securities affiliate is authorized to engage in, and a bank under the circumstances described in subparagraph (i) is prohibited from engaging in, offering investment advisory services to any investment company other than a closed-end investment company. Offering investment advisory services to a closed-end investment company which is not covered by subparagraph (iii) would be authorized to be offered both by such bank (under current Federal law) and by its securities affiliate (under subparagraph (ii) herein, which permits a securities affiliate to conduct any securities-related activity that a national bank is not prohibited from conducting).

ing Subsection 107(b) of the bill, the discussion of Subsection 104(e) above is applicable in relevant part to a savings and loan holding company and to an insured thrift institution as if they were, respectively, a bank holding company and a bank.

Subsection 104(f)—Reporting Requirements.—Subsection 104(f) amends the Bank Holding Company Act to minimize the regulatory overlap between the Federal Reserve Board and the SEC with regard to bank holding companies engaged in the securities business. For example, such companies may satisfy the Board's reporting requirements with respect to nonbank subsidiaries by submitting to the Board the same information submitted to the Securities and Exchange Commission under Section 17 of the Securities and Exchange Act.

Subsection 104(g)—State Actions.—Subsection 104(g) amends Section 7 of the Bank Holding Company Act to provide that no state may prohibit an affiliation between a national banking association and a company engaged in any of the activities authorized by Subsection 104(d), and (e) of this bill. It also provides that a state bank subsidiary of a bank holding company may engage in activities outside the bank's home state only to the extent that such activities are permissible under Section 4(c)(8) of the bank Holding Company Act. The section also applies the insurance restrictions of Title VI of the Garn-St Germain Act to bank subsidiaries of bank holding companies.

Subsection 104(h)—Judicial Review.—Federal Reserve Board orders under section 4(c)(8) and the securities affiliate section are subject to judicial review solely on questions related to the Board's findings regarding the issue of unfair competition and that the proposed activity is permissible for a bank holding company under section 4(c)(8) or section 4(c)(15) of the Bank Holding Company Act.

Section 105—Transactions Between Banks and Affiliates

Section 105 amends the Federal Reserve Act (12 U.S.C. 371(c)) by adding new Section 23B, restricting transactions between a member bank and its affiliates. Although section 23B applies to transactions between a member bank and all of its affiliates, the Federal Reserve Board is authorized to exempt affiliates from the provisions of Section 23B. As with section 23A, new section 23B is applicable to Federally insured nonmember banks through section 18(j) of the Federal Deposit Insurance Act. Furthermore, as provided in Subsection 107(c) of this bill, the provisions of Section 23A and 23B are applicable to transactions between a federally-insured thrift and its affiliates engaged in newly authorized activities.

New Section 23B provides that a member bank and its subsidiaries may engage in certain transactions with any affiliate only if the terms and conditions of the transaction, including credit standards, are substantially the same as, or at least as favorable to the bank as, those prevailing at the time for comparable transactions with nonaffiliated companies. If there are no comparable transactions, the terms and conditions of the transaction must be the same as those that, in good faith, would be offered to or would apply to nonaffiliated companies.

It should be noted that although this section generally permits a member bank and its affiliates to use similar names, it prohibits a member bank and its depository institution securities affiliate from using similar names.

Section 106—Securities Affiliates of Non-Member Insured Banks

Under current law, sections 20 and 32 of the Glass-Steagall Act, prohibiting ownership and management affiliations between securities firms and banks, applies to member banks. This provision would make sections 20 and 32 applicable to all FDIC-insured banks, with the July 1, 1983, grandfather date and two-year divestiture period for prohibited affiliations described in section 112.

Section 107—Savings and Loans Activities and Qualified Thrift Lenders

Subsection 107(a)—Definitions.—Subsection 107(a) adds new terms and definitions to the Savings and Loan Holding Company Act. "Insured institution" is revised to include all state chartered, FDIC-insured savings institutions, except those specified under the BHC Act to be banks, which will have the effect of treating any parent of such an institution as a savings and loan holding company. Under the amended definition of a "bank" in Section 2(c) of the BHC Act, such a savings bank which is in stock form and was in existence on October 15, 1982, will not be a "bank" if it has less than 10 percent of its assets in commercial loans. This will result in the holding company of such a thrift being subject to primary federal regulation by the Federal Home Loan Bank Board.

As discussed under Subsection 104(g) of the bill, the term "depository institution securities affiliate" has the same meaning as it has in the BHC Act, except that under this provision it may be owned by a savings and loan holding company. The term "depository institution holding company" means savings and loan holding company; the term "depository institution" means an FSLIC-insured or FDIC-insured thrift; and the terms "bank holding company" and "bank" each have the meaning given to them in the BHC Act.

Subsection 107(b)—Qualified Thrift Lender and Grandfather Provision.—a. Summary: Subsection 107(b) amends the Savings and Loan Holding Company Amendments to:

(1) Provide a mechanism by which certain qualified unitary savings and loan holding companies would not be subject to the provisions set forth in subsection 107(b) restricting the nonthrift activities of savings and loan holding companies.

A unitary savings and loan holding company whose sole thrift subsidiary is a "qualified thrift lender" would not be subject to the activities limitations provisions of Subsection 107(b). Such a company (a "unitary-QTL") would remain as it is now, with no limits on the parent's or nonthrift affiliate's activities. Such flexibility would, of course, include authority to engage in any activity authorized under 107(b).

A Qualified Thrift Lender ("QTL") is any federally chartered or insured thrift which is covered by and meets one of the following tests:

(a) Certain state-chartered savings banks—an institution which is, on the date of enactment of the Act, a state-chartered, FDIC-insured, stock savings bank which has 10 percent or less of its assets in commercial loans. Once such an entity goes over 10 percent, its parent is subject to the Bank Holding Company Act, not the Savings and Loan Holding Company Act; or

(b)(i) Other "insured institutions" or federally chartered institutions—such thrifts must have 60 percent or more of their assets in residential real estate (mortgages, mortgage-backed securities, real estate used in the business, and not more than 10 percent of assets from statutory liquidity requirements and from mortgage banking originations) and do not fall below such percentage on an average basis in three out of every four quarters and two out of every three years.

(ii) A federal savings bank on the date of enactment which was a state-chartered savings bank prior to October 15, 1982 would be subject to the 60 percent test but it would have 10 years to meet the test (a graduated system of compliance).

(iii) If an institution loses its QTL status, it may not regain it for 5 years. The FSLIC may allow, for good cause, 3 years to comply with this standard.

(2) Subject unitary savings and loan holding companies which are not unitary QTL's to the same restrictions on their activities as multiple savings and loan holding companies.

(3) Grandfather, under specified circumstances, certain activities of unitary savings and loan holding companies that were in existence on July 1, 1983, and which do not become unitary QTL's.

(4) Expand the activities authorized for all savings and loan holding companies to parallel generally those activities authorized under current law and under this bill for bank holding companies.

(5) provide that the Douglas Amendment will apply to savings and loan holding company acquisitions of a bank, except an emergency acquisition under Section 3(f) of the Federal Deposit Insurance Act, in order to provide treatment for savings and loan holding companies equal to that for bank holding companies.

(6) exempt a company that acquires a FSLIC-insured institition pursuant to the emergency thrift acquistion provisions of the Garn-St Germain Act from the restrictions on business activities generally applicable to savings and loan holding companies under Subsection 107(b).

(7) apply the affiliation and management interlock prohibitions of sections 20 and 32 of the Glass Steagall Act to all FSLIC-insured institutions. Any such affiliation or interlock in existence prior to July 1, 1983, would be grandfathered.

b. Grandfather provision: The general grandfathering provisions of Section 107(b) authorize a holding company that was a unitary savings and loan holding company on July 1, 1983, to continue to engage in any activity in which it was lawfully engaged on June 27, 1984 regardless of whether or not savings and loan companies may engage in such activities under Federal law. A grandfathered savings and loan holding company will immediately lose its grandfather privileges when (1) the FSLIC-insured subsidiary or FDIC-insured state chartered savings institution loses such qualification

under the tax code test (2) the grandfathered holding company acquires a commericial bank; or (3) the garndfathered holding company commences any new activities of a financial nature, other than those permissible for savings and loan holding companies under this bill. No grandfather privileges are provided for any company that acquires an insured institution between July 1, 1983, and the date this legislation becomes effective. Furthermore, the Corporation may terminate these grandfather privileges if, after a hearing, it determines that a termination is necessary to prevent conflicts of interest or unsound practiese or is in thie public interest.

c. Savings and loan holding company activities: The second paragraph of Subsection 107(b) of this bill lists the activities that are considered permissible for savings and loan holding companies. (Because Subsection 107(b) of the bill directly exempts unitary QTL's from the restrictions it sets forth for savings and loan holding companies, the term savings and loan holding company in this and the following three paragraphs include unitary QTL holding companies only to the extent that it authorizes new activities. Although a savings and loan holding company is expected to conform its activities to the list of permissible activities, this paragraph does provide a two-year grace period after the formation of a holding company for such holding company to so conform its activities. This grace period is not available, however, to any company that acquires an insured thrift between July 1, 1983 and the date this bill becomes law. This parallels the two-year grace period provided by law to bank holding companies and is intended to be applied in a parallel manner.

The activities listed in Subsection 107(b) as permissible for savings and loan holding companies include the following activities that were permissible under prior law: performing management services for a subsidiary FSLIC-insured thrift; conducting an insurance agency or escrow business holding, managing, or liquidating a subsidiary FSLIC-insured thrift's assets; holding or managing properties of a FSLIC-insured thrift subsidiary; and acting as trustee under a deed of trust.

In addition, Subsection 107(b) adds the following new permissible activities: the activities of a depository institution securities affiliate in accordance with the limitations contained in the Bank Holding Company Act as provided in Subsection 104(e) of this bill [3]; activities determined by the Federal Reserve Board, under Section 4(c)(8) of the Bank Holding Company Act, to be closely related to banking; the acquisition of shares of an export trading company in accordance with the relevant provisions of the Bank Holding Company Act (except with FSLIC rather than Federal Reserve Board approval) and subject to any rules or conditions for the conduct of this activity established by the Federal Reserve Board; the acquisition of shares of any FDIC-insured bank in accordance with applicable laws; and the activities in which multiple savings and loan

[3] For purposes of this Subsection, the restrictions set forth in Subsection 104(e) that apply to banks and bank holding companies apply to the same extent to thrifts and savings and loan holding companies, respectively. Accordingly, if a savings and loan holding company forms a depository institution securities affiliate, the holding company must transfer ali covered securities activities from its subsidiary insured institution(s) to the securities affiliate even where, for example, the subsidiary may have certain grandfather rights with respect to the securities activities conducted by the insured institution through a service corporation.

holding companies may engage directly on June 27, 1984, provided that in the case of real estate investment and development, a savings and loan holding company may only maintain its investments lawfully held on June 27, 1984, and make additional investments not in excess of 5 percent of its primary capital.[4] The FSLIC may prohibit or limit, however, a savings and loan holding company from engaging in activities determined by the Federal Reserve Board to be of a financial nature or closely related to banking.

It is intended, through this list of expanded permissible activities, that savings and loan holding companies be allowed to engage in the same activities authorized for bank holding companies, except that the FSLIC may either prohibit any activity for savings and loan holding companies or place limitations on their conduct.

d. Procedures: The savings and loan holding company must submit a notice to the FSLIC 60 days in advance of engaging in any of these activities. No notice is required where a savings and loan holding company opens offices de novo or changes the location of offices without a change of activities. (Because its activities are not restricted under the Savings and Loan Holding Company Act, a QTL holding company is not generally subject to these procedural requirements.)

The FSLIC will, by regulation, prescribe the information that must be submitted and any such required information must be relevant to the nature and scope of the proposed activity and to the FSLIC's consideration of the notice. The FSLIC, in connection with any notice, may consider the same criteria, discussed under Subsection 104(d) of this bill, that the Federal Reserve Board may consider in evaluating similar activities for bank holding companies.

The FSLIC has the authority, upon consideration of the four criteria noted above, to disapprove the proposal within the statutory time period of 60 days (which period may be extended by the FSLIC for an additional 30 days). The reasons for any disapproval or determination not to disapprove issued by the FSLIC must be set forth by written order.

Subsection 107(b) of this bill also authorizes savings and loan holding companies to acquire one or more banks. Any acquisition under this new authority is also subject to all of the limitations, conditions and requirements of the Bank Holding Company Act, including section 3(d), the Douglas Amendment. Thus, for example, both the FSLIC and the Federal Reserve Board have authority to disapprove any such acquisition.

However, it is expected that the FSLIC will defer to the primary federal regulator of the bank *i.e.*, the Federal reserve Board, FDIC or Comptroller of the Currency, in the area of the financial safety and soundness of a subsidiary bank of the holding company.

Subsection 107(b)—Foreign Savings and Loan Holding Companies.—Subsection 107(b) also amends Section 408 of the National Housing Act (the Savings and Loan Holding Company Act) to permit the activities of companies which own or control shares of a

[4] The provision concerning real estate investment and development is intended to grandfather a savings and loan holding company's lawful investments in these real estate activities as of June 27, 1984, but to permit additional investments in real estate investment and development only if such additional investment does not exceed no more than 5 percent of the holding company's primary capital is devoted to those activities.

single savings and loan association to continue to engage in certain business activities conducted exclusively overseas, certain business activities conducted exclusively overseas, provided such companies were chartered in a foreign country by June 1, 1984.

Subsection 107(c)—Affiliate Transactions.—Subsection 107(c) exempts, from the prohibitions against interaffiliate transactions set forth in the Savings and Loan Holding Company Amendments, transactions between FSLIC-insured thrifts and their affiliates engaged in any of the activities added to the list of permissible savings and loan holding company activities under this bill. It also subjects such transactions to the limitations of Section 23A and 23B of the Federal Reserve Act as if the FSLIC-insured thrift were a member bank. The FSLIC is authorized to promulgate rules and regulations with respect to Sections 23A and 23B in order to define and clarify the applicability of those Sections to FSLIC-insured institutions.

Subsection 107(d)—Simplified Holding Company Formations.—Subsection 107(d) amends the Savings and Loan Holding Company Amendments to exempt from prior approval requirements set forth therein the formation of a savings and loan holding company involving a simple reorganization of interest from individual ownership to holding company form. Thus, prior approval by the FSLIC is not required in connection with a reorganization in which a person or group of persons owning a FSLIC-insured thrift transfers shares to a newly formed holding company and receives substantially the same proportional share interest in the holding company that they had in the thrift prior to the holding company formation (except for changes due to the exercise of dissenting shareholder appraisal rights).

Under current law, the acquisition of a FSLIC-insured thrift institution is exempt from the FSLIC prior approval requirement if the institution is "acquired in connection with a reorganization in which a person or group of persons, having had control of an insured institution for more than three years, vests control of that institution in a newly formed holding company subject to the control of the same person or group of persons." This language is subject to several interpretations and is complicated because of the ambiguity surrounding the issue of when "control" is present. Therefore, the bill clarifies the meaning of a "reorganization" that is not subject to the prior approval requirement and provides a more objective criterion for determining whether a reorganization qualifies for the exemption. The requirement that the control group have had such control for three years prior to the holding company formation is deleted, since any change in control involving individuals owning a FSLIC-insured thrift is subject to the Change in Savings and Loan Control Act of 1978 (12 U.S.C. 1703(l)(6)).

Subsection 107(e)—Judicial Review.—Federal Home Loan Bank Board orders under section 408(c)(2) of the National Housing Act are subject to judicial review solely on questions related to the Board's findings regarding the issue of unfair competition and that the proposed activity is permissible for a savings and loan holding company.

Subsection 107(f)—Affiliate Powers.—Subsection 107(f) amends the Savings and Loan Holding Company Amendments to prevent a state from prohibiting the affiliation of any federally-chartered thrift institution with a company engaged in only the activities newly authorized for savings and loan holding companies under this bill.

Section 108—Demand Deposits

Federal savings and loan associations are authorized to offer demand deposits (checking accounts) to all their customers. Presently, they may only offer such accounts to businesses with whom they have a credit relationship. The existing prohibition against the payment of interest on such accounts would be retained.

Section 109—Eligibility for Advances from Federal Home Loan Banks

Members of the Federal Home Loan Bank system would be required to meet the residential real estate test for qualified thrift lenders under section 107(b) in order to obtain advances from a Federal Home Loan Bank. The Bank Board would be authorized to waive such requirement in appropriate circumstances.

Section 110—Capital Assistance Programs

The capital assistance programs established by the Garn-St Germain Act and implemented by the FDIC and the Bank Board would be extended three years beyond its 1985 expiration date.

Section 111—Leasing Authority of National Banks

This section provides that national banks may lease tangible personal property in amounts up to 10 percent of the assets of the bank.

Section 112—Securities Affiliates of FSLIC-Insured Institutions

The prohibitions against affiliation and management or employee interlocks between securities firms and member banks under sections 20 and 32 of the Glass-Steagall Act are extended to cover FSLIC-insured institutions. Such relationships existing prior to July 1, 1983 would be grandfathered and any relationship prohibited by the enactment of this Act and not so grandfathered would have to be terminated within 2 years. The continuation of an ownership affiliation also permits the continuation of management or employee interlocks.

Activities authorized for savings and loan holding companies pursuant to Section 107(b) would not be affected by this provision, nor would the ability of Federal thrifts to utilize the new mortgage securities corporations authorized by section 114 of this bill.

Section 113—Mutual Thrift Holding Companies

In order to afford all FSLIC or FDIC-insured mutual thrifts an opportunity to obtain new powers and retain their mutual character, this provision authorizes the establishment of holding compa-

nies for such institutions under the Savings and Loan Holding Company Act. The powers of such a parent include those of a multiple savings and loan holding company (except insurance activities) and of a bank holding company.

Section 114—Mortgage Securities Corporations

Section 107(b) of the Act would authorize Federal thrift institutions to underwrite and deal in mortgage-backed securities through separate holding company subsidiaries. Section 114 would authorize Federal thrifts themselves to establish or invest in separate subsidiaries of such thrifts solely to issue and service mortgage-backed securities. Through this direct investment authority, a thrift would be better able to issue its own securities and finance its operations.

TITLE II—PROVISION AFFECTING CREDIT UNIONS

Section 201.—This section restores explicit authority inadvertently removed by the Garn-St Germain Act, for federal credit unions to make unsecured home improvement loans for 15 year terms. It also provides that such home improvement loans, and all second mortgages, may be made for any term longer than fifteen years that the NCUA Board allows.

Sections 202 and 204.—These sections provide the NCUA Board with clear authority to define the risk that credit unions must insure against through their fidelity bonds for credit union employees and officers.

Section 203.—This section provides that membership officers may be selected from the credit union's membership rather than having only members of the board of directors eligible to be membership officers.

Section 205.—This section is a technical amendment to clarify that paragraphs (a) and (b) of section 118 of the Federal Credit Union Act are alternative methods of expelling a member of a credit union. There had been confusion as to whether (a) and (b) were alternative or linked. A credit union may either adopt its own policy for expulsion, as set forth in paragraph (b), or it may simply expel a member under the terms of paragraph (a) if the credit union has not adopted its own policy under paragraph b.

Section 206.—This section deletes the requirement for conversion from federal share insurance status to private or state share insurance status that twenty percent of the members of the credit union participate in the election to decide whether to convert. This section is intended to conform the insurance conversion provisions with the provisions for conversion from federal charter to state charter. The requirement that a majority of the credit union members take part in the election to convert charters was deleted from the Federal Credit Union Act in the Garn-St Germain Act. If the twenty percent requirement were not deleted from the insurance conversion provisions, two elections would be required in some cases to convert from a federally chartered and insured credit to a state chartered and state insured credit union. The conforming amendment is made to eliminate the possible necessity of two elections.

Section 207.—This section removes the sunset provision sunsetting the conservatorship authority given to the NCUA in the three year emergency acquisitions provisions of the Garn-St Germain Act. The conservatorship authority expires under the Garn-St Germain Act on October 15, 1985. This section removes that sunset provision, rendering the conservatorship authority permanent.

TITLE III—BANKERS BANKS

This clarifies that bankers banks may invest in export trading companies, provide services to bank holding companies, and makes technical changes to the banks bank statutory provisions.

TITLE IV—COMPETITIVE SAVINGS INCENTIVE

This title, separately introduced as S. 1750, directs the Federal Reserve Board to pay interest monthly on reserves held against money market deposit accounts, super NOW accounts, and any new transaction accounts authorized by DIDC after December 1, 1982, at the rate earned on the Federal Reserve's securities portfolio that month. Interest will be pro-rated to the institutions holding reserves.

TITLE V—CONSUMER LEASES AND LEASE-PURCHASE AGREEMENTS

Section 501 is entitled the "Consumer Lease and Lease-Purchase Agreement Act".

Section 502 amends the Consumer Credit Protection Act to create a new Title X as follows:

Section 101 entitles Title X of the Consumer Credit Protection Act the "Consumer Lease and Lease-Purchase Agreement Act."

Section 102 sets forth the Findings and Declaration of Purpose.

Section 102(a) states that the purposes of the *consumer leasing* provisions are to assure more meaningful disclosure of the terms of leases for personal property leases; to provide the consumer with a basis for better comparison shopping; to limit balloon payments; and to assure accurate advertisement of lease terms.

Section 102(b) states that the purposes of the *lease-purchase* provisions are to provide meaningful disclosure of the terms of lease—purchase agreements; to assure that consumers know the total cost of an item covered by a lease-purchase agreement; to tell the consumer when the item can be owned; and to assure accurate advertisement of lease-purchase agreement terms.

Section 103 sets forth the Definitions and Rules of Construction.

Section 103(a)(1) defines "advertisement" as a commercial message in any medium which promotes a lease or lease-purchase agreement.

Section 103(a)(2) defines "agricultural purposes" to include the production, harvest, exhibition, marketing, transportation, processing, or manufacture of agricultural products by a natural person who cultivates, plants, propagates, or nurtures agricultural products, including but not limited to the acquisition of farmlands, real property with a farm residence, and personal property and services used primarily in farming.

Section 103(a)(3) defines "Board" as the Board of Governors of the Federal Reserve System.

Section 103(a)(4) defines "consumer" as a natural person who leases personal property under a consumer lease or rents personal property under a lease-purchase agreement.

Section 103(a)(5) defines "consumer lease" as a contract in the form of a lease or bailment for the use of personal property by a natural person primarily for personal, family, or household purposes, for a period exceeding four months, in which the total lease cost is not more than $25,000, whether or not the consumer has the option to purchase or otherwise become the owner of the property at the expiration of the lease. The term does not include any "credit sale" as defined in Title I.

Section 103(a)(6) defines "consummation" as the time a consumer becomes contractually obligated on a consumer lease or lease-purchase agreement.

Section 103(a)(7) defines "lessor" as a person who regularly provides the use of property through consumer leases or lease-purchase agreements and to whom the obligation is initially payable on the face of the lease or lease-purchase agreement.

Section 103(a)(8) defines "personal property" as any property that is not real property under the laws of the state where it is located when it is made available for a consumer lease or lease-purchase agreement.

Section 103(a)(9) defines "lease-purchase agreement" as an agreement for the use of personal property by a natural person primarily for personal, family, or household purposes, for an initial period of four months or less (whether or not there is any obligation beyond the initial period) that is automatically renewable with each payment and that permits the consumer to become the owner of the property. Ownership might occur, for example, after a specified number of payments have been made, or upon exercise of a purchase option. The definition, for purposes of Federal law, does not include any "credit sale" as defined in Title I.

Section 103(a)(10) defines "residual value" as the wholesale or retail fair market value of the leased property at early termination or the end of the lease term in a consumer lease.

Section 103(a)(11) defines "state" as any state, the Commonwealth of Puerto Rico, the District of Columbia, and any territory or possession of the United States.

Section 103(b) states that unless the context indicates otherwise, lease means consumer lease and agreement means lease-purchase agreement.

Section 103(c) provides that references to any provision of this title include references to the regulations of the Board under this title.

Section 104 sets forth transactions which are exempt from this title.

Section 104(1) exempts consumer leases and lease-purchase agreements primarily for business, commercial, or agricultural purposes, or those made with government agencies or instrumentalities or with organizations, from this title.

Section 104(2) exempts leases of a safe deposit box.

Section 104(3) exempts leases or bailments of personal property incidental to a lease of real property where the consumer has no liability for the property at the scheduled expiration of the lease (except for normal wear and tear) and the consumer can not purchase the leased property.

Section 105 covers Regulations of this title.

Section 105(a) requires the Board to write regulations to carry out the purposes of this title. The regulations may contain classifications and differentiations and may provide for adjustments and exceptions for any class of transactions.

Section 105(b) requires the Board to publish model disclosure forms and clauses. In designing model forms, the Board shall consider the use by lessors of data processing or similar automated equipment. Use of the models shall be optional. A lessor who properly uses the models shall be deemed to be in compliance with the disclosure requirements.

Section 105(c) states that any regulation of the Board, or any amendment or interpretation of those regulations, that requires a disclosure different from the disclosures previously required under federal law shall have an effective date of the October 1 that follows the date of promulgation by at least six months. The Board may, at its discretion, lengthen or shorten that period of time. In any case, lessors may comply with any newly promulgated disclosure requirement prior to its effective date.

Section 111 sets forth the general disclosure requirements.

Section 111(a) requires a lessor to disclosure to the consumer the information required by this title. If a transaction involves more than one consumer, disclosures may be given to the consumer who is primarily obligated. If a transaction involves more than one lessor, only one lessor need make the disclosures.

Section 111(b) requires that the disclosures be made at or before consummation of the consumer lease or lease-purchase agreement.

Section 111(c) states that the disclosures shall be made clearly and conspicuously in writing, in a form that the consumer may keep. The disclosures required under sections 112 and 114 shall be segregated in a "federal box" from all other terms, data, or information provided.

Section 111(d) states that information required to be disclosed may be given in the form of estimates and identified as estimates when the lessor does not know the exact information.

Section 111(e) requires that if a disclosure becomes inaccurate after the delivery of the required disclosures, the resulting inaccuracy does not violate this title.

Section 112 requires that the following information must be disclosed for consumer leases:

(1) The total of initial payments required at or before consummation of the lease or delivery of the property, whichever is later.

(2) The number, amounts, and timing of scheduled payments.

(3) The total of scheduled payments.

(4) The total of amounts payable at the expiration of the lease (not including any difference between the anticipated residual value and the actual residual value).

(5) The total lease cost, which is the sum of items (1), (3), and (4).

(6) The amount of any required security deposit.

(7) When the consumer buys required insurance from or through the lessor, the total cost. When the consumer does not buy required insurance from or through the lessor, a statement that the consumer must buy insurance and that the cost is not included in the numerical disclosures.

(8) When any official fees and taxes are paid to or through the lessor, the total cost. When any official fees or taxes are not paid to or through the lessor, a statement that the consumer must pay official fees or taxes and that the amounts are not included in the numerical disclosures.

(9) Any dollar charge or percentage amount that may be imposed for a late payment, other than a deferral or extension charge.

(10) A statement that the consumer may be liable for additional amounts if the lease is terminated early.

(11) When the consumer's liability is based on the residual value of the property, a statement that the consumer may have the property appraised at the consumer's expense by an independent third party agreed to by the consumer and lessor, and that the parties will be bound by the appraisal.

(12) When the consumer's liability at the end of the lease term is based on the anticipated residual value of the property:

(A) The anticipated residual value of the property, marked as wholesale or retail;

(B) A brief statement of the consumer's potential liability at the end of the lease term;

(C) The product of three times the average payment allocable to a month; and

(D) A statement that the consumer's liability will generally be limited to item (12)(c) unless the excess is a result of excessive use or unreasonable wear and use, or the lessor brings a successful court action proving that the estimate of the anticipated residual value was reasonable.

(13) A statement that the consumer may have other costs and that the consumer should refer to the appropriate lease document for information about non-payment and default, wear and use standards, and maintenance responsibility.

Section 113 limits the consumer's liability at early termination or at the end of the lease term.

Section 113(a) requires that when the consumer's liability at the end of the lease term is based on the anticipated residual value of the leased property, the anticipated residual value shall be a reasonable estimate of the actual residual value of the property at the end of the lease term. This subsection creates a rebuttable presumption that the anticipated residual value is unreasonable to the extent that it exceeds the actual residual value at the end of the lease term by more than three times the average monthly payment. The lessor shall not collect any amount exceeding three times the average monthly payment unless the lessor brings a successful action in court proving that the estimate was reasonable. If the lessor

fails to rebut the presumption, the lessor must pay the cost of the action and the consumer's reasonable attorney's fees.

Section 113(b) requires that the rebuttable presumption created in subsection (a) shall not apply to the extent that the excess of the anticipated residual value over the actual residual value is due to damage to the property beyond reasonable wear and use or to excessive use. The lessor may set reasonable standards for wear and use in the lease.

Section 113(c) states that a willing consumer and lessor may make a mutually agreeable final adjustment with respect to the excess of three times the average payment allocable to a month, provided the agreement is made after the end of the lease term.

Section 113(d) permits the lessor to specify penalties or other charges for delinquency, default, or early termination, if the amounts are reasonable in light of the anticipated or actual harm caused by the delinquency, default, or early termination, the difficulties of proof of loss, and the inconvenience or non-feasibility of otherwise obtaining an adequate remedy.

Section 113(e) gives the consumer the right to obtain at the consumer's expense a professional appraisal of the property by an indepndent third party agreed to by both parties when the consumer's liability is based on the residual value of the leased property.

Section 114 requires that the following information must be disclosed for lease-purchase agreements:

(1) The number, amounts and timing of all payments necessary to acquire ownership of the property.

(2) The total of payments necessary to acquire ownership of the property.

(3) A statement that the consumer will not own the property until the consumer has made the number of payments and the total of payments necessary to acquire ownership.

(4) A statement that the total of payments does not include other charges, such as late payment, default, pick-up, and reinstatement fees, and that the consumer should see the contract for an explanation of these charges.

(5) A statement that the consumer is responsible for the fair market value of the property if it is lost, stolen, damaged, or destroyed.

(6) A statement indicating whether the property is new or used.

Section 115 covers renegotiations and extensions.

Section 115(a) defines a renegotiation as an existing consumer lease or lease-purchase agreement which is satisfied and replaced by a new lease or agreement undertaken by the same lessor and consumer. A renegotiation is a new lease or agreement requiring new disclosures. However, the following events shall not be treated as renegotiations:

(1) The addition or return of property in a multiple-item lease agreement, provided the average payment allocable to a payment period is not changed by more than 25 percent.

(2) A deferral or extension of one or more periodic payments, or portions of a periodic payment.

(3) A reduction in charges in the lease or agreement.

(4) A lease or agreement involving a court proceeding.

(5) Any other event described in Board regulations.

Section 115(b) states that no disclosures are required for any extension of a consumer lease or a lease-purchase agreement. However, a lessor that extends or permits a consumer to extend a consumer lease for more than one month beyond the end of the lease term shall recalculate the anticipated residual value of the leased property to reflect the depreciation resulting from the extended term.

Section 116(a) covers consumer lease advertising and requires that—where an advertisement for a consumer lease states the amount of any payment or states that any or no initial payment is required, the advertisement must also clearly and conspicuously state the following items:

(1) That the transaction advertised is a lease.

(2) The total of initial payments required at or before consummation of the lease or delivery of the property, whichever is later.

(3) That a security deposit is required.

(4) The number, amounts and timing of scheduled payments.

(5) For a lease in which the consumer's liability at the end of the lease term is based on the anticipated residual value of the property, that an extra charge may be imposed at the end of the lease term.

Section 116(b) states that any owner or personnel of any medium in which an advertisement appears or through which it is disseminated shall not be liable under this section.

Section 117(a) covers lease-purchase advertising and requires that when an advertisement for a lease-purchase agreement refers to or states the amount of any payment or the right to acquire ownership, the advertisement must also clearly and conspicuously state the following items:

(1) That the transaction advertised is a lease-purchase agreement.

(2) The total of payments necessary to acquire ownership.

(3) That the consumer acquires no ownership rights if the total amount necessary to acquire ownership is not paid.

Section 117(b) states that any owner or personnel of any medium in which an advertisement appears or through which it is disseminated shall not be liable under this section.

Section 121 identifies which agencies will enforce this Act.

Section 121(a) states that this Act will be enforced by the Comptroller of the Currency for national banks; by the Board for member banks of the Federal Reserve System; and by the Federal Deposit Insurance Corporation for banks insured by the Federal Deposit Insurance Corporation.

Section 121(a)(2) states that the Federal Home Loan Bank Board will enforce the Act for institutions subject to section 5(d) of the Home Owners' Loan Act of 1933, section 407 of the National Housing Act, and sections 6(i) and 17 of the Federal Home Loan Bank Act.

Section 121(a)(3) states that the National Credit Union Administration will enforce the Act with respect to any Federal credit union.

Section 121(a)(4) states that the Farm Credit Administration will enforce the Act with respect to any Federal land bank, Federal land bank association, Federal intermediate credit bank, or production credit association.

Section 121(b) states that for the purpose of the exercise by any agency referred to in subsection (a) of its power under any Act referred to, a violation of a requirement imposed by this title shall be deemed to be a violation of a requirement imposed under that Act. Each agency may also exercise any other authority conferred on it by law in enforcing any requirement imposed under this title.

Section 121(c) authorizes that Federal Trade Commission to enforce this Act, unless enforcement of the requirements imposed by this title is specifically committed to some other agency under subsection (a). For the purpose of exercising its functions and powers under the Federal Trade Commission Act, a violation of any requirement imposed by this title shall be deemed a violation of a requirement imposed under that Act. All of the functions and powers of the Federal Trade Commission under the Federal Trade Commission Act are available to the Commission to enforce compliance by any person with the requirements imposed by this title, whether or not that person is engaged in commerce or meets any other jurisdictional tests in the Federal Trade Commission Act.

Section 121(d) states that notwithstanding the authority of the Board to issue regulations under this title, any other agency designated in this section may make rules respecting its own procedures in enforcing compliance with requirements imposed by this title.

Section 122 covers civil liability.

Section 122(a) states the civil liability of a lessor who fails to comply with a requirement contained in the sections outlining general requirements of disclosure, consumer lease and lease-purchase disclosures, liability limitations at early termination or the end of the lease term, and lease renegotiations and extensions. The penalties are:

(1) actual damages sustained by the consumer as a result of the violation;

(2) in the case of an individual consumer lease action, 25 percent of the total of scheduled payments under the lease, but not less than $100 nor greater than $1000;

(3) in the case of an individual lease-purchase action, 25 percent of the total of payments necessary to acquire ownership, but not less than $100 nor greater than $1000;

(4) in the case of a class action, the amount the court determines to be appropriate with no minimum recovery as to each member, but not more than the lesser of $500,000 or 1 percent of the net worth of the lessor; and

(5) the costs of the action and reasonable attorney's fees as determined by the court.

Section 122(b) states that any lessor who fails to comply with the advertising requirements of this Act is liable for actual damages suffered from the violation, the costs of the action, and reasonable attorney's fees.

Section 122(c) provides that when there are multiple lessors, liability shall be imposed only on the lessor who made the disclosures.

When no disclosures have been given, liability shall be imposed on all lessors.

Section 122(d) provides that when there are multiple consumers in a consumer lease or rental-purchase agreement, there shall be only one recovery of damages under subsection (a) for a violation of this title.

Section 122(e) provides that multiple violations occurring in connection with a single consumer lease or rental-purchase agreement entitle the consumer to a single recovery under this section.

Section 122(f) states that action under this section may be brought in any United States district court or in any other court of competent jurisdiction within one year of the date of the occurrence of the violation, except that in the case of a violation of the early termination or end of lease term requirements of this Act, an action may be brought within one year of the end of the lease term. Consumers are not prevented from asserting a violation of this title in an action to collect the debt brought more than one year from the date of the occurrence of the violation as a matter of defense by recoupment or set-off, except as otherwise provided by state law.

Section 122(g) prevents consumers from taking any action to offset any amount for which a lessor is potentially liable under subsection (a) against any amount owed by the consumer, unless the amount of the lessor's liability has been determined by judgment of a court of competent jurisdiction in an action in which the lessor was a party. This subsection does not bar a consumer then in default on the obligation from asserting a violation of this title as an original action, or as a defense or counterclaim to an action brought by the lessor to collect amounts owed by the consumer.

Section 123 sets forth the defenses available under this Act.

Section 123(a) limits a lessor's liability under sections 121, 122, or 125 for a violation of the requirements of sections 111, 112 and 114 if within 60 days after discovering the error, and before an action under section 122 if filed or written notice of the error is received from the consumer, the lessor notifies the consumer of the error and makes whatever adjustments in the account are necessary to assure that the consumer will not be required to pay an amount in excess of the amounts actually disclosed. This provision applies whether the discovery of the error was made through a final written examination report or the lessor's own procedures.

Section 123(b) limits the lessor's liability under section 121 for a violation of this title if the lessor shows by a preponderance of the evidence that the violation was not intentional and resulted from a bona fide error even through the lessor maintained procedures reasonably adapted to avoid such error.

Section 123(c) states that a lessor is not liable under this title for any act done or omitted in good faith in conformity with any rule, regulation interpretation, or approval promulated by the Board or by any official duly authorized by the Board. This rule applies even if, after the act or omission has occurred, the rule, regulation, interpretation, or approval is amended, rescinded, or determined by judicial or other authority to be invalid for any other reason.

Section 124 identifies the liability of assignees.

Section 124(a) states that for purposes of sections 122 and 123, the term "lessor" as used in those sections shall include an assignee of the lessor. However, a civil action for a violation of this title may be brought against an assignee only if the violation is apparent on the face of the disclosure statement. An assignee has no liability where the assignment is involuntary.

Section 124(b) provides that in an action by or against an assignee, the consumer's written acknowledgement of receipt shall be conclusive proof that the disclosures were made, provided the assignee had no knowledge that disclosures had not been made when the assignee acquired the obligation.

Section 125 sets forth the criminal liability for anyone who willfully and knowingly fails to comply with any requirement imposed under this title, which is $5,000 or a prison term of not more than one year, or both.

Section 131 covers this Act's relation to state laws.

Section 131(a) provides that this title does not affect the laws of any state regarding the disclosure of consumer leases or lease-purchase agreements, and does not exempt any person subject to the provisions of this title from complying with the laws of any state with respect to consumer leases or lease-purchase agreements, unless those laws are inconsistent with any provision of this title, and then only to the extent of the inconsistency. The laws of a state are inconsistent if a person is unable to comply with them without violating a provision of this title. The Board is authorized to determine whether such inconsistencies exist.

Section 131(b) requires the Board, by regulation, to exempt any class of lease transactions and lease-purchase agreements within any state if it determines that the state law contains requirements substantially similar to those imposed by this title or gives greater protection and benefit to the consumer, and that there is adequate provision for enforcement.

Section 131(c) states that this title does not affect the validity or enforceability of any contract or obligation under state or Federal law, except as provided in sections 122 and 123.

Section 131(d) provides that determinations under this section may be requested by any state.

Section 132 states the effect of this Act on governmental agencies and provides that no civil or criminal penalty contained in this title may be imposed on the United States or any of its departments or agencies, any state or political subdivision, or any agency or any state or political subdivision.

Section 133 requires reports by the Board and Attorney General to the Congress concerning the administration of their functions under this title. The Board's report shall include its assessment of the extent to which compliance with the requirements imposed by this title is being achieved.

Section 134 contains the effective dates.

Section 134(a) requires that this title shall take effect on the October 1 that is at least two years after the date of its enactment.

Section 134(b) states that all regulations, forms and clauses required to be prescribed shall be promulgated one year prior to such effective date.

Section 134(c) permits lessors to comply with the requirements of this title, in accordance with the regulations, forms and clauses prescribed by the Board, prior to such effective date.

Section 503 sets forth technical amendments to the Truth-in-Lending Act which are required because the leasing provisions have been placed in a separate title.

TITLE VI—DEPOSIT AVAILABILITY

Section 601 entitles this Act the "Fair Deposit Availability Act of 1984."

Section 602 contains definitions.

Section 602(1) defines the depository institutions which are covered by the Act to include (a) an insured bank; (b) a mutual savings bank; (c) a savings bank; (d) an insured credit union; (e) a savings and loan association as defined in the Federal Home Loan Bank Act; and (f) any insured institution as defined in the National Housing Act. It also includes institutions that are eligible to make application to become a federally insured institution.

Section 602(2) defines the term "deposit account" as an account in a depository institution where the account holder is allowed to make withdrawals by various types of instruments or telephone transfer for the purpose of making transfers to third parties. The definition excludes time deposits and savings accounts that are not used for transactions purposes.

Section 602(3) defines the term "Board" as the Board of Governors of the Federal Reserve System.

Section 602(4) defines the term "check or similar instrument" as a check, negotiable order of withdrawal, share draft, money order or similar instruments. The definition excludes noncash items.

Section 603 contains requirements for disclosure of availability policies.

Section 603(a) requires depository institutions to provide written disclosures to customers opening an account of its general policy with respect to when a customer may withdraw deposited funds. For existing accounts, a depository institution must disclose its policy to account holders in the first regularly scheduled mailing after the effective date of this Act, unless such information has already been so disclosed.

Section 603(b) requires depository institutions to post a clear and conspicuous notice disclosing its general policy with respect to when a customer may withdraw deposited funds.

Section 603(c) requires a depository institution to provide a "brief reminder" at ATM machines that deposits may not be available for immediate withdrawal and to mail such a remainder at least annually to account holders.

Section 603(d) requires depository institutions to notify their account holders of changes in their delayed availability policies. Such notification is not required if the change expedites the availability of funds.

Section 603(e) requires depository institutions to disclose their general policy to consumers requesting this information by telephone.

Section 603(f) authorizes the Board to issue regulations designed to implement their disclosure requirements.

Section 603(g) authorizes the Board to publish model disclosure forms and clauses for common transactions to facilitate compliance with these disclosure requirements. Use of the models is not required. However, a depository institution will be considered to be in compliance with the disclosure requirements if it either uses a model published by the Board, or uses the model but changes it by deleting information not required by this title or rearranging the format.

Section 603(h) requires the Board to provide an opportunity for notice and comment before adopting model forms and clauses.

Section 604 requires depository institutions to pay interest on interest bearing deposit accounts no later than the time the institution receives provisional credit on the deposit. If that date falls on a non-business day, availability must be provided on the next business day.

Section 605 contains provisions designed to provide customers with access to their funds in a more timely fashion.

Section 605(a) instructs the Federal Reserve Board to publish for comment not later than 18 months after the date of enactment, a regulation designed to improve the check clearing system by expediting the process for returning checks or by other means to achieve the goal of (1) providing one-day availability for funds from deposits made by checks drawn on local depository institutions; and (2) providing three-day availability for funds from deposits made by checks drawn on other institutions. This section does not apply to those checks which pose a serious risk of loss to a depository institution.

Section 605(b) lists twelve considerations for the Board in promulgating its regulations. These twelve factors are:

(1) adopting a uniform endorsement standard;

(2) providing for direct notification of returning checks and similar instruments to the depository institution of first deposit;

(3) providing for direct return of checks and similar instruments to the depository institution of first deposit;

(4) providing for return of all checks and similar instruments through the Federal Reserve System's clearing house;

(5) extending limits for returns;

(6) establishing schedules for the availability of funds deposited by checks and similar instruments;

(7) prescribing the availability of funds deposited by checks and similar instruments based on the nature of the account to which the deposit was made;

(8) the use of electronic means of collecting and returning checks;

(9) providing for check truncation;

(10) the establishment of an automated return system;

(11) creating incentives for depository institutions to return unpaid items promptly to the depository institution of first deposit; and

(12) keeping the costs of any improvements to be implemented to a minimum.

This list is not exhaustive and the Board is empowered to consider and implement any other approach, or combination of approaches, that would help meet the statutory goals.

Section 605(c) requires that the Board's regulations shall become effective three years after the date of enactment.

Section 605(d) requires the Board to establish an Expedited Funds Availability Council to assist it in its exercise of the functions required by this Act. The members of the Council include representatives of the four other financial regulatory agencies, two representatives of the Consumer Advisory Council, one representative from users of payment systems services, and one from the providers of payment systems services in competition with the Federal Reserve System.

Section 606 requires the Secretary of the Treasury, by regulation, to require that funds deposited by a check drawn on the Treasury of the United States, which is first endorsed for deposit by a customer with an established relationship with a depository institution, be available for withdrawal by the date the institution received provisional credit for that check. If that date falls on a nonbusiness day, availability must be provided on the next business day.

Section 607 deals with administrative enforcement.

Section 607(a) identifies the federal financial regulatory agencies which are responsible for the administrative enforcement of these requirements. For national banks, the Comptroller of the Currency shall enforce these requirements. For State member banks of the Federal Reserve System, the Federal Reserve Board shall enforce these requirements. For other banks insured by the Federal Deposit Insurance Corporation, that agency shall enforce these requirements for savings and loan institutions, and the National Credit Union Administration is responsible for enforcement for federally-chartered or insured credit unions.

Section 607(b) provides that a violation of a requirement imposed by this Act shall be considered to be a violation of the statutory provisions authorizing enforcement by the above federal financial regulatory agencies with respect to the institutions they regulate. These agencies, of course, may also exercise any other authorities conferred by law in addition to the authorities specified in this Act.

Section 607(c) authorizes state regulatory agencies to enforce the requirements of this Act for institutions not covered in subsection (a).

Section 607(d) clarifies the authority of agencies other than the Federal Reserve Board to make rules respecting their own procedures to enforce compliance with the requirements of this title.

Section 608 contains provisions concerning civil liability.

Section 608(a) exempts violations of the telephone disclosure requirements from civil liability. For violations of the disclosure, payment of interest on deposits, and availability of Treasury checks requirements of this title, the civil liability shall be (1) actual damages; (2) statutory damages of not less that $50 nor greater than $500 for an individual action, or in the case of a class action, an amount the court will allow, with no minimum recovery applicable for each member of the class, not to exceed the lesser of $500,000 or 1 percent of the net worth of the depository institution; and (3)

court costs and reasonable attorney's fees in the case of a successful action. When awarding damages in class action, the court shall consider several factors, including the amount of actual damages awarded, the frequency and persistence of failures, the resources of the depository institution, the number of persons adversely affected, and the extent to which the violations were intentional.

Section 608(b) states that depository institutions will not be liable under this section if the violation resulted from a bona fide error which occurred in spite of procedures established and maintained to avoid any such error. Examples of bona fide errors include clerical, calculation, computer malfunction, and programming and printing errors. Errors in legal judgment are not bona fide errors for purposes of this section.

Sections 608(c) states that actions brought under this section may be initiated in any United States district court, or other court of competent jurisdiction, within one year from the date of the violation.

Section 608(d) states that liability imposed under this section will not apply to acts done or omitted in good faith in conformity with any rule, regulation or interpretation by the Board, or to acts which conform with any interpretation of approval by an official of the Federal Reserve System who is authorized by the Board to issue such interpretations of approvals; even though after the act of omission the rule, regulation, interpretation or approval is amended, rescinded or determined by judicial or other authorities to be invalid.

Section 609(a) makes it clear that nothing in the title prevents a depository institution from making funds available for withdrawal at an earlier time than required by this title or by regulations of the Board. Nothing in this title affects a depository institution's existing right (a) to accept or reject a check for deposit; or (b) if a check is accepted for deposit and provisional settlement has been made, revoke the provisional credit, charge back the depositor's account, or claim a refund for such provisional credit.

Section 609(b) provides this title's preemption standard and states that the regulations prescribed by the Board shall supersede state law where the Board determines the state law to be inconsistent with the provisions of this title or its regulations. For example, a few states prohibit the direct return of checks to the institution of first deposit. Should the Board, by regulation, require direct return of checks, those state laws would be superseded.

Section 610 requires the Board to study and submit to the Congress, one year after implementing its regulations, its findings concerning the effect of changes made by the regulations, and assessment of improvements that could be made in the check collection system, and an assessment of the use of electronics in payments.

TITLE VII—CREDIT DEREGULATION AND AVAILABILITY

Section 701 entitles this Act the "Credit Deregulation and Availability Act of 1984."

Section 702 amends Section 511 of the Depository Institutions Deregulations and Monetary Control Act of 1980, as follows:

Section 501(a)(1) states that if the applicable rate of interest which is allowed under this section (five percent over the United States Treasury's three year constant maturity rate) is greater than state law would otherwise permit for business and agricultural credit, then any lender may charge interest at the Federal rate notwithstanding state constitutional provisions or statutes.

Section 501(a)(2) provides a penalty for charging an interest rate higher than allowed by subsection (a)(1). The penalty, when knowingly done, is the forfeiture of the entire interest which the extension of credit carries with it or has been agreed to be paid. Where an interest rate higher than allowed under subsection (a)(1) has been paid, the one who paid it may initiate a court proceeding, not later than two years after the date of payment, to recover an amount equal to twice the amount of interest paid.

Section 511(b) provides definitions that describe the types of credit to which this section applies.

Section 511(b)(1) defines "agricultural credit" as credit extended primarily for agricultural purposes to one who cultivates, plants, propagates, or nurtures agricultural products.

Section 511(b)(2)—defines "agricultural purposes" to include the production, harvesting, exhibition, marketing, transportation, processing, or manufacturing of an agricultural product and the acquisition of farmland, real property with a farm residence and personal property and services which are used primarily for farming.

Section 511(b)(5) defines "credit" to include all secured and unsecured loans, credit sales, forbearances, advances, renewals and other extensions of credit.

Section 702(b) amends section 512 of the depository Institutions Deregulation and Monetary Control Act of 1982 as follows:

Section 512(a) provides that the provisions of this Title shall apply to business and agricultural credit extended between April 1, 1980, and July 1, 1987; unless the limitations set forth in the following subsection apply. This provision, therefore, sunsets the federal preemption on July 1, 1987.

Section 512(b) identifies business and agricultural credit which will not be affected by this law. This section offers the opportunity to states which have not previously overridden the federal preemption to do so within the next three years. States which have already rejected the Federal preemption need not act again, and their rejection would remain effective.

This section also contains certain transitional provisions. These transitional rules make it clear that the federal preemption applies to credit extensions made when the 1980 federal law was effective, and before the date a State rejected the federal preemption.

Section 512(c) identifies extensions of credit covered by the federal preemption.

Section 512(c)(1)(A) provides that extensions of credit which (1) have been funded or made in whole or in part during a period after passage of the 1980 federal preemption and before State action rejecting the preemption; or (2) were made before April 1, 1980 and stated a variable interest rate during such period; or (3) constitute a renewal, extension, or modification of an extension of credit (such as refinancing) which occurred during such period with the written

consent of the obligee; and meets the threshold amount requirements, are subject to the federal preemption.

Section 512(c)(1)(B) sets forth the threshold amounts required to be involved for the federal preemption to apply. The Depository Institutions Deregulation and Monetary Control Act set the minimum loan amount as $25,000; the Housing and Community Development Act reduced it to $1,000; and this act eliminates the requirement of a threshold amount. This section provides for transitional rules which state the loan amount requirements for credit extensions before and after enactment of the above statutes. It also makes it clear that a series of advances may be aggregated to meet the threshold requirements.

Section 512(c)(2) adds a transition provision that would apply if a state acted to reject the federal preemption. Under this change, the federal preemption will continue to apply to certain activities in connection with credit agreements initiated during the preemption period so long as the credit is extended within eighteen months of the state law or certification rejecting the federal preemption.

Section 703 amends the Federal Credit Union Act to permit the Board of Directors of each individual credit union to set the interest rates of the institution.

Section 704 provides that this title takes effect upon enactment.

TITLE VIII—BROKERED DEPOSITS

Section 801. This section creates the Brokered Deposits Act of 1984.

Section 802. This section adds new sections 415 and 416 to the National Housing Act. Section 415 prohibits the Federal Home Loan Bank Board ("FHLBB") from promulgating rules or regulations with respect to brokered deposits which differ from the terms of new section 416.

New section 416 limits the availability of deposit insurance on brokered deposits, by prohibiting FSLIC-insured institutions from accepting short term deposits placed by one or more "deposit brokers" in the aggregate exceeding the lesser of 200% of the institution's unimpaired capital and surplus, or 15% of its total deposits. If the institution's unimpaired capital and surplus is less than the minimum net worth requirement to be established by FHLBB, the institution is prohibited from accepting any brokered deposits.

Section 803. Section 803 amends the Federal Deposit Insurance Act to limit the availability of deposit insurance on brokered deposits in FDIC-insured institutions. It prohibits FDIC from promulgating rules or regulations with respect to brokered deposits which differ from the terms of new section 29(a) of the Federal Deposit Insurance Act.

New section 29(a), which would be enacted as part of the Brokered Deposits Act of 1984, limits the availability of deposit insurance on brokered deposits, by prohibiting FDIC-insured institutions from accepting short term deposits placed by one or more "deposit brokers" in the aggregate exceeding the lesser of 200% of the institution's unimpaired capital and surplus, or 15% of its total deposits. If the institution's unimpaired capital and surplus is less than the minimum net worth requirements established by the FDIC or

other appropriate Federal bank regulatory agency, the institution is prohibited from accepting any brokered deposits.

With respect to the amendments of both the National Housing Act and the Federal Deposit Insurance Act, a "deposit broker" is defined as any person, other than an insured institution or affiliate, which places funds or facilitates the placement of funds for or on behalf of a third party in an insured institution.

In both statutes, a "short-term deposit" shall be defined as one payable less than one year after the date of deposit, including demand deposits, or a deposit without fixed maturity payable upon written notice to be given less than one year from the date of repayment, or one payable more than one year after the date of deposit, which bears interest at a rate fixed or indexed to the rate of interest on loans or obligations with a maturity of less than one year.

Some insured institutions are holding brokered deposits as of the date of enactment of this legislation, and such deposits already taken may be held until maturity, except that deposits without a stated maturity cannot be held by an insured institution for a period of more than one month from the date of enactment. Sections 802 and 803 give the FHLBB, the FDIC, or other appropriate Federal bank regulatory agency authority to permit institutions insured by each of them to accept, or to continue to hold brokered deposits, after providing notice and application to FHLBB or FDIC in accordance with the procedures of those agencies, notwithstanding the general limitations implied by the Brokered Deposits Act.

TITLE IX—FRAUDULENT USE OF CREDIT CARDS AND DEBIT CARDS

Section 901 amends Section 134 of the Truth-in-Lending Act as follows:

Section 134(a) prescribes a fine of not more than $10,000, or imprisonment for not more than 10 years, or both, for whoever:

(1) knowingly uses or attempts to use a fraudulently obtained credit card or more than one such card for the purpose of obtaining money, goods or services valued at $1,000 or more during any one-year period;

(2) with unlawful or fraudulent intent, transports or attempts to transport a credit card;

(3) with unlawful or fraudulent intent, uses any instrumentality of interstate or foreign commerce to sell or transport a credit card, knowing the card to be counterfeit, fictitious, altered, forged, lost, stolen, or fraudulently obtained;

(4) knowingly receives, conceals, uses, or transports money, goods, services, or anything else of value which (A) has an aggregate value of $1,000 or more within a one-year period; (B) has moved in interstate or foreign commerce; and (C) has been obtained with one or more credit cards;

(5) knowingly receives, conceals, uses, sells or transports in interstate or foreign commerce one or more tickets for interstate or foreign transportation which (A) has an aggregated value of $500 or more within a one-year period; and, (B) has been purchased or obtained with one or more fraudulently obtained or improperly converted credit cards;

(6) in a transaction affecting interstate commerce, furnishes money, property, services, or anything else with an aggregated value of $1000 or more within a one-year period, through the use of a credit card, knowing the card to be counterfeit, fictitious, altered, forged, lost, stolen, or fraudulently obtained;

(7) in a transaction affecting interstate or foreign commerce, knowingly furnishes, transfers, or obtains a credit card for use in connection with a scheme to defraud a consumer or other person;

(8) in a transaction affecting interstate or foreign commerce, with unlawful or fraudulent intent, furnishes, acquires, or uses real or fictitious account numbers or other access codes; and

(9) with unlawful or fraudulent intent, possesses five or more credit cards which have moved in interstate or foreign commerce.

For purposes of this subsection, "credit card" includes counterfeit, fictitious, altered, forged, lost, stolen, or fraudulently obtained credit cards.

Section 134(b)(1) states that the dollar value of all transactions by a person using one or more credit cards in the course of conduct which violiates these provisions shall be used to determine the aggregate value of goods under subsection (a).

Section 134(b)(2) defines "credit cards" to include account numbers or other means of account access which alone, or in conjunction with other means of access, can be used to obtain money, goods and services.

Section 134(c) requires that anyone previously convicted of a violation under subsection (a) or section 916 of the Electronic Fund Transfer Act shall, for any subequent violations, be fined not more than $100,000 or imprisoned not more than 20 years, or both.

Section 902 amends section 916(b) of the Electronic Fund Transfer Act as follows:

Section 902(a) amends section 916(b) of the Electronic Fund Transfer Act by subjecting the following actions to a maximum fine of $10,000 and/or a maximum of 10 years imprisonment.

Section 916(b)(7) states that whoever knowingly furnishes, transfers or obtains a debit instrument used in connection with a scheme to defraud a consumer or other person shall be subject to the penalty provisions of the Act.

Section 916(b)(8) states that whoever with unlawful or fraudulent intent, in a transaction affecting interstate or foreign commerce, furnishes, acquires or uses actual or fictitious account numbers or other access codes shall be subject to the penalty provisions of the Act.

Section 916(b)(9) states that whoever possesses, with unlawful or fraudulent intent, five or more counterfeit, fictitious, altered, forged, lost, stolen, or fraudulently obtained debit instruments which have moved in interstate or foreign commerce shall be subject to the penalty provisions of the Act.

Section 902(b) amends section 916(c) of the Electronic Fund Transfer Act to expand the definition of "debit instrument" by including account numbers and other means of account access that can be used to initiate the transfer of funds. It excludes a transfer originated solely by paper instrument.

Section 902(c) amends Section 916 of the Electronic Fund Transfer Act by adding two new provisions which require that (1) the dollar value of *all* transactions by a person using one or more debit instruments in the course of conduct which violates the Act shall be used to determine the aggregate value of goods; and (2) the penalty for subsequent violations of the Act by any person shall be not more than $100,000, or 10 years imprisonment, or both.

TITLE X—INTERSTATE BANKING

Section 1002.—Section 1002 amends the National Bank Act (12 U.S.C. 5155) by adding an additional condition under which a national banking association may retain or establish and operate a branch. It allows a national bank to have a branch in another state from that in which it is located, (its "home state"), if (i) the other state by statute specifically authorizes state banks situated in the bank's home state to establish a branch in the other state, and (ii) the national bank's home state specifically authorizes by statute a home state bank to establish and operate a branch in the other state.

Title X continues to refer to the state branching laws, as provided in the McFadden Act. However, Title X has two additional effects. First, it contemplates the existence of state laws which would permit state banks to establish branches beyond their own state boundaries (a geographic expansion not allowed under the McFadden Act); second, it signifies Congressional consent to state statutes that would permit interstate geographic expansion into their states only on a limited basis, regionally, by way of reciprocity, or other similar conditions. The latter phrase indicates that the two conditions explicitly mentioned are not the only permissible ones. Various states have adopted a panoply of statutes addressed to expansion of banking across interstate boundaries. Because of the wide variety of statutes already enacted, the Committee does not intend the language of Section 1002 to serve as an exclusive list of the limitations states may adopt. The language referring to "other similar conditions" is intended to comprehend the variety of statutes the states may adopt.

Section 1003.—Section 1003 amends Section 3(d) of the Bank Holding Company Act of 1956 (12 U.S.C. 1842(d)). Section 3(d) of the Bank Holding Company Act generally prohibits the acquisition of any interest in a bank, or all or substantially all of its assets, by a bank holding company or a subsidiary of a bank holding company, if the target institution principally conducted its operations in a state other than the putative acquirer's principal place of business, unless the acquisition is, specifically authorized by the statutes of the state in which the institution to be acquired principally conducts its business. The bill modifies Section 3(d) to clarify that the District of Columbia, U.S. territories, Puerto Rico, Guam, American Samoa and the Virgin Islands shall be deemed to be states for purposes of Section 3(d) of the Bank Holding Company Act.

Section 1003 also amends 12 U.S.C. 1842(d) to specify that the Board of Governors of the Federal Reserve may approve acquisitions permissible under state statutes which specifically may authorize a bank holding company to acquire a bank or all or sub-

stantially all of its assets. As in Section 1002, it is recognized such state statutes may contain geographic, reciprocity, or other limits on acquisitions within its state. However, the next to the last sentence of Section 3(d) would only allow an interstate acquisition under the specific circumstances set forth in the bill, but will not permit the Federal Reserve Board to approve a later acquisition of the grandfathered acquirer by another bank holding company. Any such subsequent acquisition would have to be expressly sanctioned by the statutes of the state in which the grandfathered acquiree was located.

Section 1004.—Section 1004 amends Section 18(c)(5) of the Federal Deposit Insurance Act. Section 18(c)(5) presently identifies merger transactions which may not be approved by the agencies having jurisdiction to approve bank mergers pursuant to Section 17(c)(2). Title X adds to that list a merger from which results an FDIC-insured bank with branches in more than one state, unless the statutes of each state specifically shall authorize such a transaction. As in Section 1002, the bill provides that a state statute may allow such a transaction with geographic, reciprocity, or other similar restrictions.

Section 1005.—Section 1005 amends Section 407 of the National Housing Act to add a new provision under which the Federal Savings and Loan Insurance Corporation ("FSLIC") may approve an acquisition, merger, or reorganization of a thrift institution. Under the bill, FSLIC may permit a reorganization or merger if the proposed merger is in conformance with all applicable law, federal and state. The amendment to Section 407 contemplates that a state statute may permit such an acquisition, merger, or reorganization, but may limit transactions with out-of-state thrift institutions or holding companies by geographic requirements, requirements of reciprocity, or other similar conditions. This provision complements the similar language contained in Section 1002.

Prohibitions on acquisitions of thrift institutions, or all or substantially all of their assets, under Section 408(e)(3) of the National Housing Act, are relaxed by the bill. Section 1005 would permit such acquisitions across interstate boundaries if the laws of the state in which the target institution is located expressly permit such an acquisition. As with the other statutory amendments made by Title X, approval is given to state statutes that permit such acquisitions, subject to geographic, reciprocity, or other similar conditions to be determined by the state legislature.

Section 1006.—Section 1006 of the bill directs the President, together with the Attorney General, the Secretary of the Treasury, the Board of Governors of the Federal Reserve System, the Comptroller of the Currency, the Federal Home Loan Bank Board, and the Federal Deposit Insurance Corporation, to report back to Congress four years after enactment, with their conclusions as to the effect of Title X on the financial, economic, and banking environment, and on banks, bank holding companies, savings and loan associations, and savings banks, and with further legislative recommendations.

Section 1007.—Effective Date. Section 1007 of Title X provides that the statutory amendments enacted in Title X shall expire 5 years after the date of enactment of Title X. However, transactions

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legally entered into during the time the Title X amendments are in force shall continue to be legally valid after the expiration of Title X.

TITLE XI—MISCELLANEOUS

Truth-in-Lending Act amendment

Section 1101 deletes the 1985 sunset date to permanently exempt *advances* on open-end lines of credit secured by real estate from Truth-in-Lending Act rescission rights.

Model form amendment

Section 1102 requires the Federal Home Loan Bank Board to publish model forms for mobile home loan transactions subject to Board consumer regulations which apply when states usury laws are preempted.

Fair debt collection practices

Section 1103 deletes the exemption for attorneys from the provisions of the Fair Debt Collection Practices Act.

Payments system amendment

Section 1104 would add a new subsection (e) to Section 11A of the Federal Reserve as follows:

Subsection (e)(1) would require the Board to publish each year a statement of projected plans for price changes and additional services that the Federal Reserve banks anticipate offering during the succeeding calendar year and a statement of major capital investments with respect to payments services planned for the next three succeeding calendar years. The purpose of this requirement is to provide information to private providers of payments system services as to what changes and investments the Federal Reserve intends to make in order to enable private sector firms to plan better for their investments.

Subsection (e)(2) would require the Board to take whatever actions are necessary to assure that its regulatory responsibilities with respect to the payments system are clearly separated from the activities of the Reserve Bank staff with respect to the management and operation of payments services. The purpose of this provision is to emphasize the intent of the Congress that the Federal Reserve Banks not use their regulatory powers to enhance their competitive position in providing payments system services at the expense of private competitors.

Subsection (e)(3) would require the Board to establish a Payments System Advisory Council to advise and consult with it in the exercise of its payments system functions. The Council would include representatives of providers and users of payments services as well as the general public.

Subsection (e)(4) would eliminate geographic legal or regulatory barriers to private participants receiving deposits in the performance of payments system services, thus eliminating inequitable restrictions not applicable to the Federal Reserve System.

Now account amendment

Section 1105 would clarify that organizations operated primarily for political purposes and not for profit are eligible to own negotiable order of withdrawal NOW accounts. Under this language, political committees which are organized to support candidates for local, state and/or federal office would now have the option to use interest-bearing NOW accounts at financial institutions. The coverage would also include political party committees and the separate segregated funds commonly known as political action committees of corporations, labor organizations, trade associations, membership organizations, cooperatives and similar organizations.

Greenmail and executive compensation

Section 1106 prohibits a company from purchasing at a premium its securities from any person who holds more than 3 percent of such securities and who has held such stock for less than 2 years.

Section 1106 also prohibits companies from agreeing to provide lucrative compensation packages to officers or directors who might otherwise by adversely affected by prospective tender offers or other corporate take-over arrangements.

The effective date of these stock purchase and compensation limitations is June 27, 1984, the date of the mark-up.

Regulatory Impact Statement

In compliance with paragraph 11(b) of Rule XXVI of the Standing Rules of the Senate, the Committee makes the following statement regarding the regulatory impact of the bill. This bill represents a significant deregulation of banking and securities laws related to the packaging of private mortgage backed securities.

Changes in Existing law

In the opinion of the Committee, it is necessary to dispense with the requirements of subsection 4 rule XXIX of the Standing Rules of the Senate in order to expedite the business of the Senate.

Cost of Legislation

The Committee has requested a cost estimate of this legislation under the provisions of Section 403 of the Congressional Budget Act of 1974.

The Congressional Budget Office is preparing the estimate. However, at the time of filing, the estimate was not completed. When it is completed, it will be published in the Congressional Record before consideration of this legislation by the Senate.

ADDITIONAL VIEWS OF SENATOR GARN AND SENATOR PROXMIRE

Two specific issues dealt with during the Banking Committee's mark-up were mutual fund authority for bank holding companies and the application of Title VI of the Garn-St Germain Act to state bank and other subsidiaries of bank holding companies. Both were the subject of successful amendments: one to delete the mutual fund provisions, and the other to apply Title VI to all subsidiaries of bank holding companies. We opposed both amendments and, because of our strong feelings about both provisions, we are filing dissenting views on these issues.

INSURANCE

The issue of state bank powers came to the fore last year when South Dakota enacted a law generally permitting state banks there to engage in insurance underwriting and selling activities. The law imposed no restrictions on such activities conducted outside the state and it authorized the conduct of such activities inside South Dakota unless the activities resulted in a "substantial detriment" to insurance companies or agents located in that State. This situation, providing different treatment based on whether the activity is conducted in state or out-of-state, has been the object of much criticism. The original version of S. 2181 would have prohibited such dual treatment.

In the Committee Print, the focus of this limitation was revised and broadened. As retained in the bill as reported, the interstate activities of state banks would be limited to those activities permissible for a bank holding company under section 4(c)(8) of the Bank Holding Company Act. This is consistent with the BHC Act, which, under section 4(c)(8), affects the nonbanking activities of bank holding companies, and, under section 7, reserves to a state "such powers and jurisdiction which it now has or may hereafter have with respect to banks . . ." When a state bank operates within its own state, Congress should be very reluctant to impose restrictions on activities which a state legislature has sanctioned. Interstate activities of state banks are matters over which Congress has a legitimate interest and may impose standards, just as was done in the Committee Print.

The amendment to impose the Title VI restrictions, as contained in section 4(c)(8), on all subsidiaries and affiliates of a bank holding company goes for beyond what the BHC Act was designed to cover. The imposition of these standards and limitations on state char-

tered banks raises several issues, including the rights of states to charter and supervise institutions within their jurisdiction and the statutory framework affecting the insurance business.

Under the dual banking system, the state and the federal government both charter and supervise banks. This has been a source of strength and diversity for our financial system. To subject state banks to the nonbanking activities restrictions of the insurance provisions of section 4(c)(8) removes some of the chartering authority from states. The message is clear—Congress knows best what state banks should do in their home states, regardless of what state legislatures say or do.

Governors Lamar Alexander and Michael S. Dukakis, Chairman and Vice Chairman of the National Governors' Association's Committee on Economic Development and Technological Innovation, stated the following in a recent letter to me regarding the mark-up of S. 2181;

> The nation's Governor oppose any amendments which would place preemptive restrictions on financial institution activities legally authorized by state governments for the benefit of their respective citizens. The continued ability of each state to grant new or innovative powers to state-chartered institutions within their borders is necessary for continued economic well-being of the states and the nation as a whole. States have been laboratories of experimentation in the financial services area. They have been able to shape the powers of the institutions to meet local and economic needs and conditions.

In recent testimony before the House Banking Committee on legislative provisions on state bank powers generally comparable to those included in the Committee's bill, Walter S. Madsen, Superintendent of Banks for the State of Arizona and President-Elect of the Conference of State Bank Supervisors, described the following as some of the benefits that would be adversely affected by this statutory change:

> States operate as laboratories for change. Many states have long permitted activities which are not in all respects identical to those of either national banks or non-bank subsidiaries permitted under the Bank Holding Company Act. The ability of states to charter banking corporations carries with it the duty to determine an appropriate scope of activities. Such responsibility has resulted in important public benefits, has led to banks meeting local or specialized needs and has often resulted in subsequent action by Congress authorizing similar functions; e.g., bank branching in the 1920's and 1930's and NOW accounts in the 1970's. Indeed, one of the benefits of the dual system is that it motivates experimentation and innovation without putting the entire banking system at risk.
>
> State powers lead to local service and flexibility. Because current Congressional activity was occasioned by a state's insurance statute, it is appropriate to begin with an examination of insurance activities of state-chartered banks

under state law. Local conditions have led many states to authorize state-chartered banks to meet local insurance needs. State law, regulations and interpretations promulgated thereunder, court decisions and long-standing tradition permit insurance brokerage—for at least credit-related insurance—in 29 states. Ten (and perhaps as many as seventeen) of these states allow some amount of general insurance brokerage as well. . . Legislation prohibiting such activities within the authorizing states would be anti-competitive and an inappropriate remedy for the ills alleged.

State authority over the powers of state-chartered institutions has added a healthy degree of flexibility to our banking system. It is difficult to believe that the significant loss of flexibility and service to communities could be justified in prohibiting activities which engender no safety and soundness risk.

The preemption of state authority in this area is not in the public interest; would cast too large a net, given the current controversy; would remove from the public services that which had been offered without controversy until now; and would create unequal and unfair regulation based on organizational structure.

The insurance business has historically been regulated on the state level. The McCarran-Ferguson Act sets the federal standard that it is the states, not the federal government, which regulate this business. It is more than ironic that Congress, at the urging of various insurance groups, is now proposing to preclude state legislative actions or the potential for such actions affecting the insurance activities of state banks. Perhaps Congress should consider changes to McCarran-Ferguson, if it is going to preclude actions by states to authorize in-state insurance activities of state chartered institutions.

The application of Title VI to state-chartered bank subsidiaries of bank holding companies undermines the principle of states rights, and in so doing, weakens the ability of the states to serve as laboratories for change.

MUTUAL FUND AUTHORITY

The sponsorship of mutual funds was deleted from the Committee Print during the Committee's mark-up session, an action inconsistent with a competitive and strong financial system.

Banks have traditionally offered investment management services for trust accounts and nontrust accounts but many customers with modest amounts to invest cannot take advantage of the investment services offered by banks because of the high cost of individual investment. Due to court decisions and regulatory interpretations banks generally may not combine non-trust accounts for investment purposes. Yet, only by investing funds of many smaller customers on a collective basis can the economies of scale, professional management and needed diversification be achieved.

Opponents of authorizing bank holding companies to sponsor mutual funds allege that giving banks mutual fund authority will

lead to concentration of equity holdings because banks already "hold about 44 percent of the value of all stock owned by financial institutions". The more than 4,000 bank trust departments do hold a considerable portion of U.S. equities. What opponents fail to point out is that non-bank financial institutions, securities firms, insurance companies and others, all who may sponsor mutual funds as part of their massive holdings, hold the remaining 56 percent. If concentration is an issue at all, it is not in the banks, but in the giant insurers and financial conglomerates.

Opponents allege that banks, because of their diverse services and stockholdings are fraught with potential conflicts of interest and that mutual fund authority will increase this potential. Although, the potential for abuse of conflicts of interest in banks cannot be denied, because of existing regulation and supervision there has been no evidence of any significant abuse by banks in the exercise of their existing powers. Furthermore, opponents conveniently ignore the fact that the very same conflict potential exists for them.

> A major securities firm/financial conglomerate operates 32 mutual funds as well as providing international banking, commercial lending, underwriting, brokerage, insurance, credit and other services.
>
> Another operates 22 funds and is in commercial and consumer lending as well as securities, real estate and insurance.
>
> Another operates 13 funds as well as being a major insurer, pension fund manager, broker, underwriter and owner of an insured bank.

These firms and others are subject to the same potential conflicts and, because of their stock and bond underwriting activities, are subject to far greater potential conflicts of interest. On the other hand, the protections contained in the Investment Company Act and the securities laws—the same laws which would regulate bank holding company securities affiliates—have prevented widespread abuse of conflicts.

Opponents allege that banks tie investment services to their credit services. To effectively tie the sale of one product or service to another requires the existence of a near monopoly of the tie service which no single bank has, and, indeed, the entire industry lacks. Credit is available to those who would be mutual fund investors from over 14,000 banks, 20,000 credit unions, thousands of thrifts, finance companies and others, many of whom already offer mutual funds. There are so many credit providers that this argument is without merit. Moreover, tie-ins are already unlawful—they violate both the anti-trust laws and the Bank Holding Company Act.

Now is the time for Congress to provide investors of modest means a truly free choice in selecting an investment manager. In 1969, the Senate passed a bill containing no-load mutual fund authority for banks. So, like many of the other matters dealt with in the pending bill, this issue has been the subject of extensive previous review and action.

The bank securities affiliate under the proposed legislation would be subject to the same law—the Investment Company Act—that governs the funds sponsored by securities firms, insurance

companies or retailers. Competition for the public's investments under the same rules should be Congress' goal, and mutual fund authority for bank holding companies is consistent with it.

JAKE GARN.
WILLIAM PROXMIRE.

ADDITIONAL VIEWS OF SENATOR HEINZ

Because the Commitee Report was drafted, completed, and filed while the Senate was in recess, I have not had an opportunity to review it in as much detail as I would like. I therefore intend, once the Senate has reconvened, to present the full text of my additional views on the Senate floor, and they will appear in the Congressional Record.

Although I generally support the Financial Services Competitive Equity Act (S. 2851) and the accompanying Report, I am compelled to express my strongest dissent to those provisions of Title I which would allow banks and bankholding companies to engage in various securities activities not presently permitted. I find it alarming that the Congress would seriously consider at this time undermining the Glass-Steagall Act which has served our nation so well for more than fifty years by establishing the twin pillars of the American financial system: first, a safe and sound banking system; and second, the strongest, most diverse, and most competitive capital market that exists anywhere in the world.

JOHN HEINZ.

ADDITIONAL VIEWS OF SENATOR PROXMIRE

S. 2851 is a constructive attempt by the Committee to close some of the more gaping loopholes in our banking laws while providing banking institutions with limited new securities powers. The most damaging loophole closed is the so-called "non-bank bank" loophole which has undermined the separation of banking from other businesses while paving the way for unrestricted interstate banking. The bill also plugs the so-called South Dakota loophole by restricting the ability of States to authorize insurance powers for bank holding companies beyond those available in the Bank Holding Company Act. Finally, the bill closes the loophole in the Glass-Steagall Act which allows state chartered banks not members of the Federal Reserve System to engage in the securities business.

Most banking bills are the product of compromise, and S. 2851 is no exception. The Committee had to balance the drive for further banking deregulation against the need to maintain a safe and sound banking system. The benefits of more deregulation had to be weighed against the potential costs of undue concentration or conflicts of interest. Difficult choices had to be made on what services were to be allowed bank holding companies and in some cases, decisions were reached only by a close vote.

By and large, the bill reported by the Committee is a conservative approach to financial restructuring. The Committee rejected the sweeping deregulation proposals of the Reagan Administration which would have allowed bank holding companies to engage in a wide variety of real estate, insurance and other financial services. Instead, the Committee essentially reaffirmed the major objectives of our current banking laws as embodied in the Bank Holding Company Act and the Glass-Steagall Act. These laws seek to enforce a separation between the business of banking and other lines of commercial and financial endeavor. They were enacted in previous Congresses in order to promote safe banking, prevent conflicts of interest and unfair competition, and avoid an undue concentration of economic power. These objectives were valid when they were first enacted into law and they remain valid today.

In establishing our financial framework, the Congress has traditionally looked upon banks as unique institutions broadly affected with a public purpose. This is because banks are the dominant supplier of short-term business credit, the major source of back-up liquidity for our economy, the custodians of the nation's payment system and the principal transmission belt for our nation's monetary policy.

Because of the unique and crucial role played by banks in our economy, Congress has sought to limit their activities so that they can carry on their important functions with objectivity and impartiality and thus ensure safe and sound banking practices. Of course, the corollary of a policy of keeping banks in banking is to

keep other businesses out of banking. Separation of function is a two way street. It makes no sense to confine banks to a limited range of activities while permitting unregulated entities to offer products and services unique to banking. For that reason, Congress has also made it illegal for non-banking firms to own banks or to offer products unique to banking such as checking accounts.

In addition to limiting the activities of banks, Congress has also limited the ability of banks to branch across state lines. The Bank Holding Company Act prohibits the ownership of banks outside the state where the holding company is based unless specifically permitted under the law of the targeted state. As a result of these prohibitions, the banking system of the United States is more decentralized than any major country. In most advanced industrial countries, the top 10 banks have upwards of 90 percent of banking deposits; in the United States, the top 10 banks have less than 30 percent of bank deposits.

A decentralized banking system promotes not only greater competition but also more local control over local credit decisions. With over 14,000 banks in our country, most borrowers can have access to a locally owned and controlled bank to meet their credit needs. If we were to convert to a highly concentrated European banking structure, most of the credit decisions affecting our local economies would be made in New York, Chicago, and a few other financial money centers.

CHALLENGES TO CONGRESSIONAL BANKING POLICY

The Congressional policy of maintaining a separate and decentralized banking system has come under attack from three fronts. first, attorneys have shown remarkable ingenuity in discovering and expanding upon loopholes in our present banking laws in order to circumvent existing legal restrictions. The "non-bank bank" is a classic example. Under the Bank Holding Company Act, an institution is not a bank unless it both makes commercial loans and accepts demand deposits. If it foregoes one of these two services, it is not a bank for Bank Holding Company Act purposes even though it may have been chartered as a bank under State or federal law.

If a bank wants to avoid the restrictions of the Bank Holding Company Act, it can simply convert all of its demand deposits to NOW accounts and turn itself into "non-bank bank". It can then be owned by any company no matter how far removed its business may be from banking. Similarly, existing bank holding companies can evade restrictions on interstate banking by purchasing or establishing non-bank banks across state lines irrespective of state law. Or a bank that wants to get into exotic new activities not permitted to banks or bank holding company, and engage in the forbidden activities through a separate subsidiary of the holding company.

In short, the non-bank bank loophole makes a shambles of the Bank Holding Company Act. There are now hundreds of applications for non-bank banks awaiting approval by the federal bank regulators. Most of these are from giant, money center banks seeking to establish non-bank banks in other states. The Comptroller of the Currency, an ardent proponent of interstate banking, has

vowed he will approve most of these applications unless Congress acts to prevent it. Thus, if Congress does not close the non-bank bank loophole, our decentralized banking system can be radically transformed almost overnight.

A second challenge to Congressional banking policy has come from the federal bank regulators themselves. One of the shortcomings of our bank regualtory system stems from the fact that the regulators are often drawn from and return to the banking community. As a result, regulators tend to view restrictions on banks more from the perspective of bankers—that is, as obstacles to "progress" where progress is defined as an ever expanding empire for the banking business. Efforts to restrict banks are not seen as legitimate objectives of public policy but rather as the efforts of selfish industries to protect themselves from bank competition.

Given this mind-set, bank regulators have often ignored the statutory framework regulating banking established by Congress in favor of their own views on how the financial services industry should be structured. For example, the FDIC recently declared that the 50 year old Glass-Steagall Act prohibition separating banking from the securities business should no longer apply to state chartered banks that are not members of the Federal Reserve System. The Comptroller of the Currency aided and abetted the development of the non-bank bank loophole through "creative" interpretations of federal law. The Federal Reserve, whose members are generally not bankers, has been the only agency that seems to give any deference to the laws passed by the Congress.

The third challenge to Congressional banking policy has come from some States which have come to look upon their banking laws as instruments of economic development to be redesigned simply to lure a few hundred clerical jobs into a state. For example, in early 1983, South Dakota amended its banking laws to permit its state chartered banks to engage in virtually any kind of insurance activity. In doing so it carefully provided that these insurance activities could not be performed inside the State if they would adversely affect insurance companies or agents operating within the state. But no such restrictions are applied to operations outside the state.

Shortly after the South Dakota law was passed, Citicorp, the nation's largest bank holding company, applied to buy a South Dakota bank with the intent of using that bank to engage in a nationwide insurance business. While South Dakota may gain a few hundred banking jobs, the Congressional policy of keeping banking and insurance separate was undermined. In effect, South Dakota determined banking policy for the other 49 states while insulating itself from the consequences of its own actions.

NEW SECURITIES POWERS

While S. 2851 reaffirms current banking policy as established by Congress, it nonetheless does provide bank holding companies with limited new securities powers. In particular, it would allow bank holding companies to underwrite and deal in municipal revenue bonds and mortgage backed securities. There is no credible evidence that the basic objectives of the Bank Holding Company Act

or the Glass-Steagall Act would be threatened if bank holding companies were authorized these two limited powers.

With respect to underwriting municipal revenue bonds, it should be noted that when Congress passed the original Glass-Steagall Act in 1933, it specificially allowed banks to continue underwriting general obligation bonds of State and local governments. The Congress determined that the abuses involved in underwriting corporate securities did not extend to underwriting municipal bonds. As a result, banks have continued to underwrite general obligation bonds of state and local governments during the last 50 years with no documented instances of abuse.

Unfortunately, in providing an exception for general obligation bonds, the Congress failed to distinguish between these bonds and municipal revenue bonds which, in 1933, were a seldom used means of municipal finance. A general obligation bond is backed by the full faith and credit of the state whereas a revenue bond is backed by the revenues from a specific project such as bridge tolls. Today, revenue bonds account for more than half the volume of municipal financing although banks by law are precluded from competing. Studies over the years have indicated that the cost of issuing municipal revenue bonds could be reduced if banks were allowed to compete directly with investment banking firms as they do in the general obligation bond market.

Because investment banking firms have a monopoly on revenue bond underwriting, there is considerable economic concentration in this market which translates into less competition and higher borrowing costs for state and local governments. The 10 leading underwriters of revenue bonds (all of which are investment banking firms) accounted for 49 percent of the market in 1982. By way of contrast, the 10 leading underwriters of general obligation bonds (where commerical banks can compete) accounted for only 29 percent of the market. Moreover, the revenue bond market is becoming more concentrated over time whereas just the opposite is true of the general obligation bond market.

Since bank underwriting of revenue bonds will lower state and local borrowing costs, state and local organizations strongly support the Committee's action. These include the Government Finance Officers Association, the National League of Cities, the National Governors Association, the National Conference of State Legislatures, the National Association of Counties, and the U.S. Conference of Mayors.

The other new power authorized for bank holding companies is to underwrite and deal in mortgage backed securities. A mortgage backed security is a bond type instrument secured by a pool of conventional mortgage loans. These new instruments have been developed in the private sector as a way of enhancing the flow of funds into residential mortgage investments. While banks can issue mortgage backed securities as originating mortgage lenders, they are precluded by law from selling them to the ultimate investor.

As in the case of revenue bonds, the market for mortgage backed securities will be strengthened if banks are allowed to compete with investment banking firms. The ultimate beneficiary will be the American homebuyer whose borrowing costs will be reduced. For these reasons, this provision of the bill is supported by the Na-

tional Association of Homebuilders and the National Association of Realtors.

FLAWS IN THE BILL

Notwithstanding the substantial benefits of S. 2851, it must still be regarded as a seriously flawed product. In closing some loopholes, it opens others and creates more competitive inequities; it needlessly interferes with the right of a state to determine whether state banks can offer insurance services within its own borders; it weakens the ability of the bank regulatory agencies to deal with problems such as brokered deposits; it encourages a merging of the banking and thrift industries that may not be in the best interest of a strong home financing system; it promotes regional interstate banking in a way that sacrifices local control over banking without maximizing competition; and most seriously, it hands large banks a $4 billion bonanza at the expense of the U.S. Treasury.

THE $4 BILLION BIG BANK BONANZA

Title IV of the bill would require the Federal Reserve to pay interest on certain reserve balances maintained by banks and other depository institutions. The payment of interest on reserves would increase the budget deficit by nearly $4 billion over the next six years and for that reason is strongly opposed by the Reagan Administration. The cost estimates were prepared by the Congressional Budget Office and are in line with similar estimates calculated by the Treasury and the Federal Reserve.

Under the Federal Reserve Act, banks are required to maintain reserves against a specified percentage of their deposits. These reserves are held at Federal Reserve banks and help the FED to control the nation's money supply. Since 1913, when the Federal Reserve system was created, interest has not been paid on reserves.

The principal assets of the Federal Reserve are U.S. Treasury obligations which it buys and sells through open market operations. These assets are financed through Federal Reserve notes (currency) and the reserve deposits of banks. After paying its administrative expenses, the Federal Reserve returns the interest income on its investments to the Treasury where it is treated as a revenue item. Thus if the FED were to pay interest on the reserve deposits of banks, it would have less money to return to the Treasury. Federal revenues would decline and the Federal budget deficit would increase.

The vast majority of depository institutions are not required to keep reserves at the FED. Of the 40,000 depository institutions in the United States, only 4,600 actually maintain reserve balances at the FED. Just 122 of the nation's largest banks account for 65 percent of all reserves at the FED.

From the standpoint of the Federal budget deficit, the payment of interest on reserves has exactly the same effect as if Congress were to appropriate unrestricted cash grants to be given to the larger banks with the bulk of the payments going to a mere handful of giant money center banks.

The only redeeming feature of Title IV is that it does not require the payment of interest on all reserves. Instead, it requires interest

only on reserves held against money market deposit accounts and super NOW accounts. Both of these accounts were authorized in 1982 and enable banks to offer instruments competitive with money market Mutual funds. Reserves against these accounts now comprise about 10 percent of total reserves, but with the payment of interest, are projected to account for half of all reserves by 1988.

The proponents of Title IV make three arguments: (1) Non-interest bearing reserves are an unfair tax on banks; (2) Non-interest bearing reserves place banks at a competitive disadvantage compared to nonregulated entities such as money market mutual funds offering similar products; and (3) Large money center banks are in financial difficulty because of their foreign loans and need to have their earnings bolstered. None of these arguments stands up to close scrutiny.

First, banks are one of the least taxed industries. According to the Joint Committee on Taxation, the 20 largest banks paid taxes equal to 2.7 percent of their U.S. income in 1981. Ironically, banking spokesman often cite the requirement to keep non-interest paying reserves as partial justification for this embarrassingly low rate of taxation.

Second, commercial banks do not need any financial aid from the American taxpayer to help them in their battle with money market mutual funds. The banks have been hugely successful on their own. In December of 1982, money market mutual funds had assets of $233 billion compared to only $43 billion in money market deposit accounts at bank and thrift institutions. By March of 1984, money market mutual fund assets had declined to $186 billion while money market deposit accounts at banks and thrifts soared to an astonishing $393 billion. As a practical matter, the marketing benefits of having Federal deposit insurance and access to the Federal Reserve Discount Window more than outweighs the cost of non-interest bearing reserves.

Third, no commercial bank spokesman has ever argued that interest on reserves is needed as a bail-out for improvident foreign loans. Nor have the bank regulators. If a bail-out is indeed required, it should be justified on the record and targeted to those institutions that actually need it.

At a time when Congress has cut back on virtually every program to aid the poor, the elderly, the disadvantaged and the handicapped in order to curb our budget deficit, it is ludicrous that the Committee should ask the Senate to vote to increase our budget deficit by another $4 billion in order to benefit a handful of large money center banks who have made absolutely no showing that they need relief.

THE SAVINGS BANK LOOPHOLE

While the bill closes some loopholes, it creates new ones that will cause new difficulties in the years ahead. One of these is the loophole carved out for a handful of large savings banks. Under the bill's general regulatory scheme, savings and loan associations and savings banks are regulated under the Savings and Loan Holding Company Act. That Act provides that the activities of a savings and loan holding company must be closely related to the business

of banking unless the parent holding company owns only one thrift institution. In the latter case, no restrictions are placed on the activities of the parent as long as the subsidiary thrift holds 60 percent of its assets in mortgage related investments, that is, it is a "qualified thrift lender."

The qualified thrift lender test applies to all savings and loan associations, and to all existing mutual or federally chartered savings banks. However, an exemption is made for approximately 20 state chartered stock savings banks. These favored 20 would not have to meet the qualified thrift lender test as long as they did not hold more than 10 percent of their assets in commercial loans. Given the narrow definition of commercial loans contained in the bill, which I discuss below, an exempted savings bank could substantially exceed the 10 percent commercial lending limit without losing its exemption. If an exempted savings bank does exceed the 10 percent commercial loan test as newly defined, it becomes regulated under the Bank Holding Company Act, and any owner of such a bank would be subject to all of that Act's limitations on activities not closely related to banking.

The practical effect of the 10 percent commercial lending test is to give the favored 20 savings banks virtually unlimited ability to engage in any activities they wish regardless of their charter limitations. If such a bank wanted to operate a gambling casino, it would only have to form a holding company to hold the stock of the bank, and then operate the gambling casino as a seprate subsidiary of the holding company. While there is no evidence of any savings bank wanting to get into the gambling business, the example does nonetheless illustrate the extraordinary freedom conferred on the favored 20 savings banks by this new loophole.

There does not seem to be any rational reason why the Committee would bestow such favors on only a few savings banks. A commercial bank that had less than 10 percent of its assets in commercial loans would still be subject to the restrictions of the Bank Holding Company Act. Likewise, a savings and loan association that met the 10 percent commercial lending test would not be freed from the restrictions of the Savings and Loan Holding Company Act unless it also met the 60 percent qualified thrift lender test. Even an existing mutual savings bank that subsequently converts to a stock savings bank would not be able to escape the qualified thrift lender test. On what basis, then, can we justify the extraordinary generosity accorded the 20 favored savings banks? There is little evidence the Committee understood or appreciated the unusual and unfair advantage it was giving to a relatively small number of institutions.

THE COMMERCIAL LENDING LOOPHOLE

Another serious loophole created by the bill can be found in the definition of "commercial loan" under section 104(a)(3). The definition is important because it determines whether or not an institution is subject to regulation under the Bank Holding Company Act. The narrower the definition, the more institutions are allowed to escape regulation. By setting up a broad list of instruments that

are not deemed to be commercial loans, the bill adopts an extremely narrow definition of commercial lending.

For example, a commercial loan would not include a loan secured by real property. Thus a $100 million loan to General Motors would not be considered to be a commercial loan if it were secured by the company's property. Call loans to stock brokers would not be commercial loans. Typical instruments of business finance such as bankers acceptances or commercial paper would not be regarded as commercial loans. Thus under the bill's definition, an institution could engage in a substantial amount of commercial lending without being regarded as being in the business of making commercial loans.

The 10 percent leeway for state chartered stock savings banks discussed above, can also cause problems in the case of large institutions. For example, a large savings bank with assets of $10 billion could make commercial loans (as narrowly defined) of up to $1 billion and still not be regarded as being in the business of making commercial loans. It is ludicrous that a billion dollar commercial loan portfolio would not qualify an institution as a commercial lender.

Under current law, the definition of what constitutes a commercial lender has been left up to the Federal Reserve Board. The reported bill will substantially impair the ability of the Federal Reserve to administer the Bank Holding Company Act and to prevent abuses. The Federal Reserve opposes the Committee's definition and has indicated it "opens a new and broader loophole than exists under current law and is contrary to the stated purpose of the bill".

THE GREAT GRANDFATHER GIVEAWAY

Although the bill is titled the "Financial Services Competitive Equity Act", in some cases it creates as many competitive inequities as it removes. Perhaps the worst inequity created by the bill is the grandfather rights given to those firms that purchased a non-bank bank prior to July 1, 1983. It is true that as a condition for retaining its bank, a grandfathered firm must not engage in any new activities of a financial nature, or purchase another depository institution, or allow its non-bank bank to engage in commercial lending. But even with these restrictions, the owner of a non-bank bank is given a competitive advantage in perpetuity over its business rivals.

One of the most basic principles of financial institution regulation is that all firms similarly situated should play by the same set of ground rules. If the rules are modified or tightened, the new rules should apply equally to all participants. Grandfather rights are an affront to the principle of equal treatment and have no basis in either logic or equity. Certainly, most of the firms who purchased a non-bank bank did so with the knowledge they were exploiting a legal loophole, and that the loophole might some day be closed. The Committee should have turned a deaf ear to the importunings of a few large firms anxious to keep their non-bank banks and required instead that everyone play by the same rules.

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BANKS OWNING THRIFTS

By a tie vote of nine the Committee rejected an amendment that would have deleted from the bill authority for bank holding companies to purchase thrift institutions and authority for savings and loan holding companies to purchase commercial banks. Under current law, these cross industry acquisitions are generally prohibited unless they involve a failing institution.

If the Committee's recommendation is permitted to stand, there is a real danger that the separate existence and identity of the thrift industry will gradually disappear. More and more thrifts will become subsidiaries of bank holding companies and thus subject to the financial strategies and philosophies of their bank oriented parents. The strong commitments thrifts now have to mortgage finance could become eroded if the industry becomes dominated by commercial banking interests.

A merging of the bank and thrift industries could also end the healthy diversity of opinion expressed by the two major trade associations representing commercial banks and savings and loan associations. In shaping our financial structure, Congress benefits by having a diversity of viewpoints. We would not be well-served by a single, monolithic view of what our financial system should look like.

BROKERED DEPOSITS

The growing use of brokered deposits constitutes a serious risk to the safety and solvency of the of our financial system. As indicated by the FDIC, brokered deposits were a major factor in half of the most recent bank failures. The widespread availability of brokered deposits enables a poorly run institution to vastly expand its resources almost over night in pursuit of whatever get rich quick schemes its management can devise. Congress never intended that our deposit insurance system be so mis-used.

Title VIII of the bill purports to establish limits on the use of brokered deposits, but it does so in such a way that the heads of the FDIC and the FSLIC beleive it worse than no legislation at all. It sets exceedingly generous limits on the amount of brokered deposits a depository institution can accept and then removes the authority of the regulators to precribe lower limits, even in those cases where the institution might be in serious supervisory difficullty.

Even worse, no limits whatsoever are prescribed for brokered deposits with maturities of more than one year. If an institution wants to evade the limits contained in Title VIII, it can merely accept brokered deposits with maturities of one year and one day, secure in the knowledge that their regulators are forbidden by law from restricting them by regulation.

Here is how William Issac, the Chairman of the FDIC, summed up Title VIII:

> Over the years bank regulators have been repeatedly chastised in oversight hearings for failure to detect trends, anticipate problems, and move with alacrity to correct them. In the case of brokered deposits, we see a clear and

present danger to the deposit insurance system. Title VIII not only fails to address this threat, it represents a large backward step and will shackle us in our efforts to maintain safety and stability in the financial system. In our judgment, it is clearly worse than no bill at all eve if our current regulation on brokered deposits is determined to be invalid on appeal.

INTERSTATE BANKING

Title X of the bill on Interstate Branching is designed to validate the regional interstate banking arrangements entered into by several states. These arrangements typically provide for reciprocal regional interstate bank acquisitions for specified states but not for others. As an example, a regional interstate banking arrangment for New England would allow reciprocal acquisitions among the six New England states but not New York. Similarly, a proposed regional arrangment among eleven Western states excludes California.

These arrangements have been challenged in the courts by banking institutions based in the excluded states. Essentially, the argument is that while Congress may have given the States the authority to allow or not allow bank acquisitions within its borders by out-of-state bank holding companies, it did not give the States the right to exclude bank holding companies based in any particular state. The intent of Title X is to validate these exclusionary regional arrangments and thus insulate them from legal challenge.

I am opposed to interstate banking, regional or otherwise and I therefore voted against Title X in Committee. Despite the voluminous hearings held by the Committee on financial deregulation, almost all of its time was spent on what products and services are proper for banking institutions. It spent very little time on the issue of branching. It is not all clear that the regional compacts are an appropriate solution to the branching issue. What is clear is that the Committee did not seriously examine the need for changing our current branching policy nor did it explore alternatives to the regional banking concept.

The Chairman of the Federal Reserve Board has indicated some reservations on the regional banking approach and has warned that it could lead to the balkanization of the American economy. In some ways, regional interstate mergers achieve the worst of both worlds. They undermine the principle of local control while failing to maximize competition from all banks in the system.

If we are able to have interstate branching (and I do not believe it has been established that we should) then it might make more sense to open up the system to all potential players while establishing concentration limits to prevent any one holding company or group of holding companies from dominating the economy of a state. In any event, the entire branching issue needs to be more carefully explored before the Congress rushes headlong into a non-solution solution to what may be a non-problem problem.

WILLIAM PROXMIRE.

ADDITIONAL VIEWS OF SENATOR D'AMATO

It is always painful to take exception to parts of generally beneficial legislation which otherwise enjoys support and acclaim from many of our colleagues and is the product of such labor by a legislative craftsman like Senator Jake Garn. However, when a mistake is imminent, when an error may be compounded, it becomes impertative to take a strong and vigorous exception to portions of a bill to which the full attention of the Senate must be directed in order to prevent adverse consequences.

I refer to the portions of the bill dealing with expanded securities powers and with the regional banking provisions in Titles I and X, respectively. Both need attention, both need redress in order to forestall an untimely change of major public policies in ways disadvantageous to the financial marketplace and the citizenry at large.

For some time now, the print media and airwaves have been filled with stories of an expanding role for our many financial institutions as they evolve in a modern technological world. Where they are going and on whose behalf has been the subject of speculation and debate for many years. This bill is an attempt to deal with the "new world" of financial services. However, it does so on two major issues in ways to which I must make direct contrary comment regarding the committee's decisions.

As Chairman of the Securities Subcommittee, I must draw attention to Title I as being inadequate to the task to controlling the competitive forces of the securities market. In confers new powers on chartered institutions which have been denied securities underwriting powers since the Great Crash and the Depression of the 1930's. What I fear is that the jury has come in after an inadequate hearing of all the evidence, that a spasm of deregulation has replaced the deliberative policy reform which should characterize major shifts in the roles assigned to economic elements in our economy. Some change is good, some reform is dangerous—to know the difference must be our goal as legislators.

Change which Congress sanctions becomes the new economic reality for the industries involved, be they banks, thrifts, or securities firms. But change which Congress does not condone also influences the mode of commerce and finance. Operating in the midst of state and federal regulatory variety and with the tensions and tugs of the competitive world, these financial players test and strain every sinew of the existing legal body to gain for themselves an advantage. It is up to us to decide whether there is more at stake than marketability in financial services and it is up to us to decide which changes meet the test of necessity, equity, and fairness to all competitors and to the public.

It is not up to unelected regulators or state bodies to interpret what federal laws say, nor should it be necessary to pass laws repeatedly to keep well-meaning reformers from creating new poli-

cies based on their own enthusiasms of the moment at the cost of long-held and time-tested national principles which protect the public and stablize the marketplace.

TITLE I

The Supreme Court of the United States, less than three weeks ago, in *Securities Industry Association et al.* v. *Board of Governor of the Federal Reserve System et al.,* 82-1766, pointed out that one of the principal restraints that Congress intended to impose on banks with the Glass-Steagall Act was on the urge to be a promoter of securities which was stated to be "fundamentally incompatible with its role as a disinterested lender." Quoting an earlier Supreme Court opinion, it said:

> In sum, Congress acted to keep commercial banks out of the investment banking business largely because it believed that the promotional incentives of investment banking and the investment banker's precuniary stake in the success of particular investment opportunities was destructive of prudent and disinterested commercial banking and of public confidence in the commercial banking system.—401 U.S., at 634.

The court went on to refer to a bank's "saleman's interest" as impairing its ability to "function as an impartial source of credit." Supra, at 17. It pointed out the pressures on a bank trying to compete as a commercial paper dealer, the temptation, in order to enhance the marketability of an issue by extending back-up credit to the issuer with relaxed credit standards. The Court also noted the Congressional concern that banks might use the power of their relationships to the detriment of their duties as bankers.

By giving banks a pecuniary incentive in the marketing of a particular security, commercial-bank dealing in commercial paper also seems to produce precisely the conflict of interest that Congress feared would impair a commercial bank's ability to act as a source of disinterested financial advice. *Supra,* at 18. The Court succinctly stated Congress' conclusion that "the mere existence of a securities operation," no matter how carefully and conservatively run, is inconsistent with the best interest "of the bank as a whole." Supra, at 19.

Neither the present state of the banking industry nor the reasoning as recently ennunciated by the Supreme Court represents any foundation upon which to base the grant of additional securities powers to depository institution holding companies. This is no time to consider adding one iota of risk to the banking system. Use of a securities affiliate will not insulate or protect depositors' funds from the speculative losses of the affiliate, as was indicated by no less than Federal Reserve Board Chairman Volcker in January, 1984 testimony before this Committee. Vice Chairman Martin has expressed similar sentiments. The conflicts-of-interest problems, the promoter/lender tensions, remain.

There are several simple points to be made:

(1) No case had been made that the Congressional decision to separate the roles of commercial banks and securities dealers was not

a wise one. Indeed, the proponents of S. 2181 admit its validity by asserting how its reordering of the financial landscape is compatible with the Glass-Steagall Act. It is not.

(2) Banks have a special role to play in our economy. To play that role Congress affords banks favorable tax treatment, special benefits and privileges, federal deposit insurance, sometimes overly indulgent federal regulators—ultimately backed by the American Taxpayer--with great powers to rescue banks from their mistakes, misjudgments, excesses and speculations. Congress excluded banks from most securities activities because of the risks to banks but also because of the inherent conflict in the role of impartial provider of credit and the role of promoter of securities. It also recognized the pressure on a bank with a promoter's stake in the sale of a security to relax its credit standards, the temptation to promote securities to its depositors, the ease with which a bank can use its credit power to give it an unfair competitive advantage by explicit or implicit tie-in proposals. We need to preserve that special role for banks and they should keep their special privileges to compete against those who have not been granted those special privileges by the federal government. Indeed, public policy should be exactly to the contrary and, in large part, it is now and should not be changed as S. 2851 would do. Unfair advantage is precisely what is involved when holding companies are allowed into the securities business. While the affiliate structure neutralizes some of the advantages banks have, the principal ones remain-bank credit power, access to cheap capital, the exclusive right to take deposits, federal deposit insurance and federal credit back-up.

(3) While banks claim that great savings will result from their entry into revenue bond underwriting, their major attempt to document this claim resulted in total failure. The series of hearings held by the House Banking Committee in 1979 completely refuted their claims and in fact showed that the revenue bond market already has a more than ample critical competitive mass and that no public benefit would be served by amending the Glass-Steagall Act to permit bank underwriting. A fascinating outcome of those hearings, by the way, was recognition of the tremendous advantages banks now enjoy in their present scope of tax-exempt financing. For example, their tax advantages are so great that they could easily outbid securities dealers virtually every time. That they do not shows that their tax savings are not passed on, but kept in the bank. With all due respect to the desires voiced from time to time by various public organizations, governors and mayors in support of their local banking institutions, the facts just do not justify the claims made and do not warrant a major change in national banking policy. We are also concerned about competition and the spread of bank power outside the field of banking will, we fear, lead not to more competition, but less.

(4) Where a bank can operate in two roles its credit power can come in to play. The underwriting of securities, specifically enterprise securities such as revenue bonds, mortgage-backed securities such as revenue bonds, mortgage-backed securities and corporate debt, is particularly susceptible to the unfair advantages a bank can gain from its tying potential. This is more true than ever in the kinds of volatile capital markets we have today when resort to

bank letters and lines of credit by issuers of tax-exempt and other securities in common. Is it an inducement or temptation to a bank to extend a letter of credit to an issuer of revenue bonds if it can also be the underwriter of those bonds? That is precisely the kind of incompatibility of roles cited by the Supreme Court in *Securities Industry Association et al.* v. *Board of Governors of the Federal Reserve System et al.,* supra, at 19. As for the issuer, is it under pressure to use a bank, or does a bank have an unfair advantage, as revenue bond underwriter if the bank can supply a letter of credit and a securities firm cannot? You can rest assured it certainly is and the bank does. One of the most compelling pieces of evidence of this was presented to the Securities Subcommittee of the Senate Banking Committee on February 12, 1982: In a study of underwriting by three major commercial banks of single family mortgage revenue bonds in 1981, it was found that the three banks were included in the revenue bond underwriting management groups of 24 letter of credit put bond transactions; in all 24 issues the banks were provider of the vital letter of credit. In all 24 cases the same banks also were granted the highly desirable contracts to invest the bond proceeds and related funds for the lives of the bonds. It appears as if none of the banks was a manager in a housing bond issue in 1981 where it did not supply a credit facility. To me, this is dramatic proof of the inherent unfair advantage of federally-subsidized banks in the securities business. S. 2851 does nothing to address the problem.

(5) Private mortgage-backed securities represent less than two percent of the present MBS market. The mortgage-backed securities issued by federal agencies support the lower and moderate-income homeowner. This is also the market undergirded by federal credit support. The completely private MBS market is intended to serve the higher income homeowner with large mortgage loans and where federal agency back-up is not warranted. Banks should continue to be limited to assisting the low and moderate homeowners through underwriting and dealing in those MBSs with federal agency credit support, which MBSs are also safer. SEC Chairman Shad takes a very dim view of banks dealing in these securities. Private MBSs are much like corporate debt and trade just like it. There is no federal credit support. It is market risk, pure and simple. There is no public policy reason for banks entering—with all of their advantages, with all of the potential for conflicts—into that private market.

(6) What the Supreme Court has said so eloquently in *Securities Industry Association et al.* v. *board of Governors of the Federal Reserve System et al.,* 82–1766, on commercial paper should be enough. The inherent conflict in the roles of objective lender and underwriter or agent of commercial paper sales compels the conclusion that the roles should be kept separate.

(7) The capital markets of this country are the best in the world. They are not dominated by a few universal banking organizations as is the case in other countries of the world where the capital markets are sluggish and inefficient. In the United States we have succeeded in building diverse and dynamic capital markets which in very large part own their success to the separation of banking and securities dealings mandated by the Glass-Steagall Act.

(8) Who benefits from banking deregulation? Not the low and middle-income person, but only the affluent, in the view of Consumer Federation of America Executive Director Steve Brobeck. He cautions against the erosion of safety and soundness brought on by "go-go banking." He warns, "We take security and safety too much for granted." Consumers who have presented views on expansion of bank powers outside of banking are almost unanimously in opposition. And, of course, deregulation for banks is a fiction in any event. Continental Illinois shows we cannot let a major bank fail. What a comfort for creditors to know it can deal with a major bank without fear of loss no matter what the bank or its affiliates are doing. That's deregulation? That's fair competition?

The need at this time is not to have banks pushing farther and farther into commerce. We need them to concentrate on banking. We are faced with federal bank regulators unwilling to live with the spirit of laws passed by Congress as set forth in the Bank Holding Company Act and the Glass-Steagall Act. Therefore, our need at this time is to get rid of the loopholes or technical flaws in these statutes. That is all. We need to direct our regulators to concentrate on their principal responsibilities—maintaining a safe and sound system of banking. We all know we need it and that it can stand great improvement. We should close the loopholes and tell the regulators to get on with their work.

TITLE X

I vehemently disagree with the action of the Committee in approving S. 2851 with Title X included. Title X is, purely and simply, protectionist legislation, designed to provide an opportunity for a limited number of large banks in a few states to acquire a limited number of other large banks in a few states. The end result of this protectionist legislation will be the creation of a highly concentrated banking market within each of the regional compacts blessed by Title X.

The protectionists of Title X have never argued, and cannot argue, that consumers in the states covered by the regional compacts involved will benefit. Consumers will be treated to fewer banking options, less innovation in banking services and probably higher and less flexible pricing practices as the market becomes more concentrated. The consumer is the loser—the major banks of the states in the compacts are the winners.

There are other losers besides the consumers. Small banks, for example, will probably not seem attractive acquisition targets to the large banks in these states because there will be nothing to restrict them from acquiring other large banks. Market expansion can be completed faster and more effectively by acquiring large banks rather than small ones. The small banks, therefore, will have fewer (if any) potential acquirers while shareholders of larger banks will be wooed by a variety of suitors within the compacts.

Banks from states outside of the compacts will be losers also. Banks occupying states such as New York or California will probably never be included in a compact because of the reluctance of large banks within compact states to compete with the banks of those states. The potential market for banks in New York and Cali-

fornia will, therefore, be restricted to a single state, much to the detriment of those banks and the consumers in the compact states to whom those banks could have brought the benefits of competition.

Regional compacts are economic balkanization. Some balkanization plagued relationships among the colonies and among the States of Confederation. The Commerce and Compact Clauses of the Constitution were created in great part to avoid the dangers inherent in such balkanization. Title X runs rough-shod over such concerns and turns the clock back to the pre-Constitution days of groups of states joining together to discriminate against other states. It is not an exaggeration to say that the concept inherent in Title X strikes at the very heart of the idea that binds the United States together. States are an elemental part of the United States, but they cannot be permitted to join together to discriminate against another state or states—that destroys the concept of a Union.

It is surprising that the Committee could approve of Title X in light of these kinds of considerations. Title X, as I said before, is purely protectionist legislation of the most blatant kind. It is anticompetitive, it strikes at the basic percepts of the Constitution, it is harmful to consumers and benefits only a few large banks.

It is often argued that legislation which would permit states to form regional interstates compacts is merely a matter of confirming states' rights. This argument, however, turns to the Constitution on its head. Under present law (Section 3(d) of the Bank Holding Company Act), states now have the right to permit interstate banking, reciprocal or otherwise. That is state's rights.

Proponents of compact legislation now propose to go further and permit states to set up compacts, including some states and excluding others. Apparently it is feared, with good reason, that states cannot set up such compacts on their own without running afoul of the Constitution; therefore specific Congressional authorization is needed to override in effect the Compact and Commerce Clauses of the Constitution. These clauses were adopted for the specific purpose of preventing just this type of state action. How can the issue of states' rights, which derive from the Constitution, now be invoked to promote a type of state action which is specifically prohibited in the same document?

It is argued that regional compacts will provide a limited experiment in interstate banking. This argument, unfortunately, misreads the forces which will be unleashed by regional compacts. In NOW account legislation, which is often cited as a precedent for compacts, the Congress was capable of limiting this modest experiment on a state-by-state basis. With regional compacts, the Congress is in effect abdicating the interstate banking issue to the state legislatures.

This compact phenomenon has grown rapidly since compact legislation was first introduced at the federal level. It is not hard to imagine that within a year or so the majority of states will be members of four or five compacts which cover the country, except for a few isolated states purposely left out—New York, California, and possibly, Texas and Illinois. As discussed more fully below, a rash of intra-regional mergers will have taken place, without Con-

gressional input, which will permanently change the nature of the banking industry in this country.

It is not surprising that Members of Congress may not be aware of the full import of compact legislation since such legislation has really never been the subject of hearings. The Senate Banking Committee hearings on S. 2181 contain almost no discussion of compacts; the focus of those hearings was on new powers, not in the geography question.

If the Congress were to decide to phase-in interstate banking, it might well choose to begin by adopting a regional approach—permitting contiguous state banking, for example. However, the regional economic argument in connection with state compacts is simply belied by the facts. The regions which are being created simply have nothing to do with natural market areas; they are being created based on the economic protectionist fears of the bankers who are promoting them.

One simple fact says it all: Utah has adopted a bill creating a region of eleven Western states—including Alaska and Hawaii, but excluding California. Is this a natural market area?

Two regions are being set up which in effect surround, but exclude, New York state. The New England zone includes Connecticut, where the 40,000 residents who work in New York far exceed those commuting to Massachusetts, much less Maine. The proposed Middle Atlantic zone would match New Jersey with Maryland but ignore the more than 200,000 commuters from New Jersey to New York.

Many Members of Congress have expressed the concern that interstate banking will lead to a wave of mergers which will raise concentration levels and lower competition. And yet Congress is considering permitting a systm which will create the worst possible competitive situation, without any federally imposed limits on concentration levels and, indeed, as discussed above, basically without any hearings.

Under current antitrust law, it is now widely understood that there are almost no limits on so-called market extension mergers in the banking industry. Where two banks compete in the same market, antitrust law will generally prohibit the consolidation of two banks with large market shares. However, where there is little or no direct competition involved—such as when the largest bank in one state acquires the largest bank in another state—the merger will be permitted. Thus, for example, when the Pennsylvania law was recently changed to permit state-wide banking, Mellon, the largest bank in the state and in Pittsburgh, was able to acquire Girard, one of the largest banks in Philadelphia and in the entire state.

In New England, where bank concentration levels are already generally high, the very largest banking institutions are signing agreements to merge with each other. Applications for three such mergers have been approved by the Federal Reserve Board, but have been stayed pending a court ruling on the constitutionality of the compact laws. Within the proposed Southeast zone, an agreement has been signed by very large banking institutions in Florida, South Carolina, Alabama, and Georgia which will lead to a combination as soon as the region is created. One can only presume that

large institutions in North Carolina and elsewhere will soon be added to this agreement.

The result of compact legislation will be a large number of mergers between the largest banks in the various states in a region. For example, a region of, say, seven states which now has twenty to twenty-five regional banks may within a few years only have five or six.

Furthermore, these new regional giants will be protected by law from direct perspective, the result will be worse than a total repeal of all prohibitions on interstate banking. Surely those in Congress who have expressed concern about the impact on concentration levels of interstate banking cannot condone such a result.

If Congress wishes to conduct experiments with respect to interstate banking, it should do so in a manner which is fair to all states and which protects against undue concentration. At the very least, Congress should fully understand the implications of compact legislation.

It is no longer a question of whether or not interstate banking should not be permitted. It is already here—and mostly in the hands of non-banking institutions. The issue is how to relieve our present banking system of a hodgepodged and gerry-mandered network of interstate barriers in order to create an efficient, competitive, and nationwide banking system for the distribution of complete lines of financial products. The benefits of this transition for both users and providers of banking services have been frequently enumerated:

(1) more complete, convenient and faster services, and lower prices resulting from increased competition;

(2) greater availability of funds and capital where needed, which means creation of new jobs and expansion of tax base in local economies;

(3) stronger financial institutions through the spreading of risks over a wider range of customers and markets;

(4) stronger managements of banking institutions and ability to capitalize on technological innovations and economies of scale and scope.

Regional interstate banking compacts are not a step forward in strengthening the nation's commercial banking industry or in bringing the benefits of national interstate banking to both individual and institutional users of banking services. Conversely, they represent a backward step by imposing new sets of geographic barriers and conflicting regulatory and statutory constraints on the banking industry. Regional banking creates the illusion of promoting interstate banking while actually furthering traditional protectionism on a larger scale; it merely freezes and delays the process of achieving the benefits of full national interstate banking.

Regional interstate banking compacts discriminate unfairly against consumers, businesses and banks in states excluded from such arrangements. Interstate banking regions are not defined on a logical or consistent basis and ignore both the national marketplace and economically integrated markets which overlap state and regional boundaries. For example, commuters who live in one state and work in another state outside a banking region are denied the convenience and other benefits of using only one bank for all their

banking needs regardless of its location. In Connecticut, the 40,000 residents who work in New York far exceed the number of Connecticut commuters working in Massachusetts. Yet those in Connecticut who work in New York are unfairly discriminated against by state legislation which has established a New England banking region.

A proposed Middle Atlantic interstate banking region which would include New Jersey but would exclude New York makes even less sense. It would deny to the more than 200,000 commuters from New Jersey who work in New York the benefits of a one-stop banking relationship.

The recently passed Utah legislation which would create a region of eleven Western states including Alaska and Hawaii, but excluding California cannot be viewed as a logical combination of states for interstate banking purposes.

There is extensive testimony citing the benefits of free competitive entry into banking markets—benefits which would not accrue with entry limited only to regional banks.

U.S. Assistant Attorney General William Baxter has testified, "When existing banks face competitive entry conditions, they often charge lower interest rates, pay higher rates on deposits, lower their fees and service charges, and generally improve their performance. In my view, the important benefits to be gained from the potential for increased competition if geographic restrictions are eliminated appear clearly to outweigh any dangers of increased concentration." (Hearings before Senate Committee on Banking, Housing and Urban Affairs, 98th Congress).

Regional banking would continue to restrict the free flow of funds from outside a regional to capital deficient states. Combining states which are capital deficient into a larger region will not solve the problem of increasing funding services. Unrestricted entry would open up additional sources of funds from bank holding companies located in other states—including money center banks with ready access to money center markets.

> Overall the evidence suggests that the primary benefit of BHC entry into a community hinges on the more aggressive lending policies of BHC banks. This can be an important benefit because it means individuals and businesses in the community will be able to obtain more bank credit that they would if BHCs were not present—Federal Reserve Journal, January 1976.

The most frequently cited argument given in support of regional interstate banking arrangements is the fear that if large bank holding companies from outside are admitted, they will come in and dominate regional markets by swallowing up existing banks. There is no evidence that such activities would or could occur. In fact, there is substantial evidence to the contrary.

Federal Reserve Board and Justice Department restrictions would not permit mergers or acquisitions which would result in undue market concentration. Attorney General William F. Smith has observed, "there are about 14,000 banks in the United States. Neither market concentration nor aggregate concentration is a serious prospect. As for cartels or mergers, the antitrust laws them-

selves are sufficient to prevent any anti-competitive market concentration from these sources without artificial regulatory barriers." (American Banker, April 8, 1982). Furthermore, the amount of available capital for acquisitions would set self-imposed limits for even the largest bank holding companies.

In New York State where intrastate barriers were removed eight years ago, the facts show that the five largest New York City bank holding companies have not increased their dominance as a result of this geographic expansion. Conversely, they now have a smaller share of total deposits in the state than before they were permitted to branch upstate.

Both large and small banks can survive in a competitive atmosphere. In California, where statewide banking has been the rule for many years, small banks prosper and start up regularly. During 1981 and 1982, 95 new banks began operations in California. Total deposits of small banks (assets under $100 million) grew at a 75% faster rate than total deposits of the larger banks.

In summary, interstate banking has been spreading piecemeal as a result of diverse actions by state legislatures, Federal regulators, individual banks and non-banking institutions. In the absence of Congressional action to remove the remaining geographic barriers, a gradual approach via state actions is an acceptable means of phasing in national interstate banking. Under no circumstances, however, should regional arrangements, which freeze banking into selected locales and discriminate unfairly against banks and bank customers be permitted to continue.

It is interesting to note that regional compacts which have been created are the types of compacts which traditionally have been condemned by the Constitution and by courts interpreting the Constitution. Courts generally have upheld only two types of interstate compacts—compacts that were designed to promote cooperation among states and which were open to all states who wished to join (see for example Uniform Law to Secure the Attendance of Witnesses From Within or Without a State in Criminal Proceedings, or the Multi-State Tax Commission), and compacts that had no substantial federal implications (for example, the Colorado River Compact of 1921). Such compacts have been referred to by some courts as "catalysts of cohesion" reflecting efforts to harmonize interstate relations with the needs of each state. Decisions upholding interstate agreements commonly are targeted to agreements which have not had the objective of discrimination but rather that of cooperation on matters of exclusive interest to the states that are parties to the agreement. The regional interstate banking compacts that have been created, however, are radically different in purpose and effect. Instead of promoting cooperation the discriminatory compacts increase the economic and political power of the compact states at the expense of all of the other states in the Union and affect a matter of significant national concern by interferring with and disrupting federal comprehensive regulation of interstate banking.

It is also interesting to note that Title X has carved out an exemption for certain unnamed acquisitions that have been contemplated and agreed to but not consummated. In other words, Title X exempts mergers or acquisitions "the agreement and plan" for

which were "entered into on or before August 4, 1983." What mergers are these and why should these mergers have precedence over any other unconsummated mergers? Where is the tidiness in these restrictions? If there are benefits which accure from permitting these unnamed mergers to proceed, then there must be benefits which accrue if others as of yet uncontracted-for mergers were also permitted. If no benefits flow from these unnamed exempted mergers, why should they be exempted?

At the appropriate time, should it be necessary, I will have additional comments and observations to make about Title X of S. 2851. I will offer amendments which, in my judgment, will correct the deficiencies inherent in Title X and remove the protectionist features.

Economic balkanization cannot be permitted. The Union between the states has existed for too long to permit a reversion to the loose relationship that existed prior to the adoption of our Constitution.

AL D'AMATO.